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IN THE OFFICE OF THE CLERK

# Supreme Court of the United States

OCTOBER TERM, 1993

WEST PENN POWER COMPANY,
ARMCO ADVANCED MATERIALS COMPANY
and ALLEGHENY LUDLUM CORPORATION,
*Petitioners,*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION AND
MON VALLEY ENERGY CORPORATION,
*Respondents.*

**On Petition for a Writ of Certiorari to the Commonwealth Court of Pennsylvania**

## APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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## APPENDIX A

## THE SUPREME COURT OF PENNSYLVANIA
## WESTERN DISTRICT

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January 13, 1994

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West Penn Power Company
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In Re: West Penn Power Company v. Pa. Public Utility Commission
No. 0672 W. D. Allocatur Docket 1992

Gentlemen:

The Court has entered the following Order on your Petition for Allowance of Appeal and the Motion for Admission Pro Hac Vice in the above-captioned matter:

"PER CURIAM:

AND NOW, this 30th day of December, 1993, the Petition for Allowance of Appeal, and the Motion for Admission Pro Hac Vice are DENIED.

Mr. Justice Larsen did not participate in the decision of this case."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

## APPENDIX B

## THE SUPREME COURT OF PENNSYLVANIA
## WESTERN DISTRICT

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In Re: Armco Advanced Materials Company and Allegheny Ludlum Corporation, Petitioners v. Pennsylvania Public Utility Commission
No. 0663 W. D. Allocatur Docket 1992

Gentlemen:

The Court has entered the following Order on your Petition for Allowance of Appeal and your Motion for Admission Pro Hac Vice filed in the above-captioned matter:

"PER CURIAM:

AND NOW, this 30th day of December, 1993, the Petition for Allowance of Appeal, and the Motion for Admission Pro Hac Vice are DENIED.

Mr. Justice Larsen did not participate in the decision of this case."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

**APPENDIX C**

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

---

No. 340 C.D. 1992

WEST PENN POWER COMPANY,
*Petitioner*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

---

No. 353 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

---

Argued: June 17, 1992

---

Before: HONORABLE DAVID W. CRAIG, President Judge
HONORABLE JOSEPH T. DOYLE, Judge
HONORABLE BERNARD L. MCGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE DAN PELLEGRINI, Judge
HONORABLE ROCHELLE S. FRIEDMAN, Judge
HONORABLE JAMES R. KELLEY, Judge

OPINION BY PRESIDENT JUDGE CRAIG
FILED: September 3, 1992

In this consolidated case, West Penn Power Company, Armco Advanced Materials Corporation, and Allegheny Ludlum Corporation [1] appeal a decision of the Pennsylvania Public Utility Commission. Mon Valley Energy Corporation has intervened in support of the commission's decision.

*History*

In October 1987, Mon Valley entered into an electric energy purchase agreement (EEPA) with West Penn for energy to be produced at the Shannopin Mine Project, a proposed qualifying cogeneration facility (QF) under section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 796. Mon Valley is the developer of that QF.

The project is designed to be a 80 megawatt (MW) coal-fired cogeneration facility that will simultaneously produce electric power to be sold to West Penn and steam to be sold to the Shannopin Mining Company for use in its coal drying facility.

In January 1988, West Penn submitted the EEPA to the commission for approval. Armco/Allegheny, two large industrial customers of West Penn, intervened in the approval proceeding to contest rates contained in the EEPA. The commission entered a Tentative Opinion and Order on July 8, 1988, granting West Penn's approval petition, without first holding a hearing on the matter.

On August 22, 1988, this court issued its decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296, *reargument denied*, 119 Pa. Commonwealth Ct. 115, 550 A.2d 257

[1] The appellants Armco Advanced Materials and Allegheny Ludlum will be referred to as Armco/Allegheny throughout this opinion.

(1988) (*Milesburg I*). That case involved the commission's approval of an EEPA between West Penn and another QF, Milesburg Energy, Inc. The court held that, before the commission may approve the legality of a contract for a utility's purchase of power from a QF that includes substantial payments for capacity, due process requires that the utility's customers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action, because such approval by the commission is adjudicatory in nature and involves substantial property rights of ratepayers.

Thereafter, the commission withdrew its Tentative Opinion and Order granting the approval petition for the Shannopin Project and, on September 30, 1988, consolidated the Shannopin Project proceedings for hearing purposes with three other pending petitions for approval of contracts between West Penn and QFs. Following remand of the record after the court's disposition of the commission's petition for reargument in *Milesburg I*, the commission consolidated that case for hearing with the other three and assigned the case to the Office of Administrative Law Judges for hearing and recommended decision.[2]

An administrative law judge (ALJ) conducted a hearing on the consolidated cases over eight days in April of 1989. He bifurcated the hearing into Phase One, relating to a determination of the proper capacity rates to be paid to the QFs, and Phase Two, relating to issues arising from litigation delays.

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[2] In the course of denying the commission's petition for reargument in *Milesburg I*, this court held that because the case presented questions of first impression, the resolution of which could not have been clearly foreshadowed, the decision would have only prospective effect. Therefore, the commission was not required to provide notice and a hearing in the cases consolidated with the *Milesburg* case, including that relating to the Shannopin Project, but the commission elected to do so.

In the Phase One proceeding involving the Shannopin Project, the ALJ issued a recommended decision holding that the time of "agreement in principle on price" employed by West Penn in regard to the QF contract satisfied the commission's standard of time of "serious negotiations" as the time as of which full avoided costs [3] should be determined. He also approved the time-of-serious-negotiations standard itself. Armco/Allegheny had argued that the date when the utility and the QF execute an EEPA is the proper date to use to calculate a utility's avoided costs, because that is the date when a QF becomes legally committed to deliver power. The commission essentially adopted the ALJ's Phase One recommended decision.

West Penn appealed that decision to this court, which reversed the commission, concluding that the date when a QF becomes legally obligated to a utility, rather than the date of serious negotiations, is the date to use to determine the avoided costs for the purpose of establishing capacity rates in an EEPA. *Armco Advanced Materials Corporation v. Pennsylvania Public Utility Commission* (No. 2091 C.D. 1989, July 17, 1990) (*Shannopin I*).

Mon Valley was not involved in the Phase Two proceedings in April 1989, when the ALJ bifurcated the proceedings, because the commencement date for its project and the related milestone dates were later than those dates for the other projects in the consolidated proceedings.

In the Phase Two proceedings, the commission held that it was obligated to ensure that litigation delays did not result in the termination of two of the other projects, Burgettstown and Milesburg.

---

[3] Avoided costs essentially represent the money a utility would otherwise spend if it had to construct a facility to produce needed energy it purchases from a QF.

With regard to Milesburg, the commission ordered that West Penn enter a new EEPA with Milesburg, because the original EEPA had expired by its own terms. The new EEPA contained terms identical to the terms of the original, but with new milestone dates that would reflect the date of a final non-appealable order terminating the proceedings.

In the case of the Burgettstown EEPA, the original EEPA had not expired, because the commission had granted the QF's motion to stay the original financing closing date in the EEPA. The commission ordered that the Burgettstown EEPA be modified to extend the financing closing date and related milestone dates in the original EEPA to reflect the litigation delays.

On April 20, 1990, before this court decided the Phase One issues in Shannopin I, Mon Valley filed its petition for modification of the EEPA, a motion for stay of the good faith deposit requirement of the EEPA, and alternatively, a motion to enjoin West Penn from implementing Section 6.2 of the EEPA. Under the terms of the EEPA, the agreement would expire if Mon Valley did not make the good faith deposit of $120,000 on May 1, 1990.

On April 27, 1990, Commissioner William H. Smith issued an Emergency Order granting the stay of the May 1, 1990 good faith deposit requirement. On May 10, 1990, the commission ratified the stay of the good faith deposit requirement. The stay prevented the automatic termination of the EEPA pending the outcome of proceedings regarding the modification petition.

In a pre-hearing order, the ALJ indicated that all rate issues fell within the scope of the Phase One proceedings and were beyond his jurisdiction and that the scope of the Phase Two hearing would be limited solely to the reasonableness of the modifications Mon Valley was requesting. As indicated above, the sole issue in the *Shannopin I*

case involved the question of whether the date of serious negotiations or the date a QF becomes legally obligated to deliver capacity or energy is the date upon which to determine avoided costs.

Based on the narrow scope of the petition and hearing, the ALJ struck pre-filed direct testimony submitted by West Penn in which the witnesses testified regarding West Penn's avoided costs. The testimony suggested that those costs had become zero and that, therefore, if West Penn were forced to continue with its agreement with Mon Valley, the result would be excessive costs to its rate-payers.

The ALJ recommended that the commission grant Mon Valley its requested modifications. The commission accepted the ALJ's recommendations.

*Issues*

In this appeal, West Penn and Armco/Allegheny raise the following issues: (1) whether the commission has jurisdiction to modify the terms of the EEPA while an appeal from the commission's approval of the original contract is pending before this court; (2) whether the commission erred by entering interlocutory emergency and stay orders which granted Mon Valley relief from its contractual commitments to West Penn under the terms of the EEPA; (3) whether the commission has authority to modify an EEPA; (4) whether the commission's granting of new terms of the EEPA creates a new contract which requires a new determination of avoided cost under 18 C.F.R. § 292.304(d) as of the date of the allegedly new legally enforceable obligation; (5) whether the commission's contract modifications are improper because they are not just and reasonable to West Penn's customers or in the public interest as required by PURPA; and (6) whether the commission erred in striking the testimony of two of West Penn's witnesses regarding avoided costs, which testimony West Penn purport-

edly offered to help determine whether Mon Valley's requested modifications to the EEPA satisfied PURPA's requirement that rates contained in EEPAs be just and reasonable and in the public interest.

1. *Does the commission have jurisdiction over a petition to modify the terms of an EEPA during a period when an appeal from the commission's approval of the original EEPA is pending before this court?*

Both West Penn and Armco/Allegheny argue that the commission was without jurisdiction to modify the terms of the EEPA.

Armco/Allegheny relies upon Pennsylvania Rule of Appellate Procedure 1701(a), which provides

> General rule. Except as otherwise prescribed by these rules, after an appeal is taken or review of a quasijudicial order is sought, the trial court or other government unit may no longer proceed further in the matter.

Armco/Allegheny points out that subsection (b) of that rule provides for six exceptions to the rule—situations in which an administrative body may act even after a matter has been appealed:

> 1) actions necessary to preserve the status quo, correct formal errors, cause the record to be transcribed, or take other actions ancillary to the petition for review proceeding;
>
> 2) actions to enforce any order entered in the matter;
>
> 3) grants of reconsideration;
>
> 4) authorizations for depositions and preserving testimony;
>
> 5) actions authorized or directed by Commonwealth Court;

6) continue proceedings if a nonappealable interlocutory order has been entered

Armco/Allegheny has addressed exception 1, which allows a tribunal to take actions to preserve the status quo and to take other actions that are ancillary to the matter being appealed.

As Armco/Allegheny notes, status quo has been defined as "the last actual, peaceable and lawful, non-contested status which preceded the controversy." *Miceli v. Unemployment Compensation Board of Review*, 519 Pa. 515, 521, 549 A.2d 113 116 (1988).

Armco/Allegheny asserts that, under that definition, the status quo in this case was the relationship between West Penn and Mon Valley under the terms of the original EEPA, and that the commission's grant of the modifications changed that status quo.

Armco/Allegheny also addresses an exception in Pa. R.A.P. 1701(c), which the Supreme Court has stated is intended to "prevent appeals of collateral issues from delaying the resolution of the basic issues where the proceeding below can continue without prejudicing the rights of the party seeking the interim review." *Rosen v. Rosen*, 520 Pa. 19, 24, 549 A.2d 561, 564 (1988). Armco/Allegheny asserts that the present case does not fall within the ambit of this rule because, it argues, the resolution of the entire case at the commission level was completed when the commission issued its final order in September 1989 approving the EEPA and because, when that decision was appealed, there were no remaining issues for the commission to decide.

In response to the above arguments, Mon Valley and the commission contend that the commission's granting of the modifications preserved the status quo of the contractual relationship.

Mon Valley argues that the commission's determination of the modification petition was critical to preserve

the contractual relationship pending the outcome of the Phase One appeal and to reflect the impact of that appeal on the contract.

In the Phase One appeal, the only aspect of the capacity rate that was challenged was the date to be used for determining the capacity rate because at the time Mon Valley became legally obligated to West Penn, conditions relevant to the rate determination, the federal and state corporate income tax rates were lower than at the time of serious negotiations.

The commission's order in the Phase Two proceeding does not affect that aspect of the Phase One determination, the Phase One appeal, or this court's remand in the Phase One appeal. In *Shannopin I,* this court only directed the commission to adjust the rates to reflect the date Mon Valley became legally obligated to West Penn. In that case, as discussed above, the significance of the change in date resulted in lower capacity rates only because the corporate tax rate as of that date was lower than on the date of serious negotiations.

In this Phase Two proceeding, the method of calculating the rate has not been challenged. Furthermore, as discussed below, West Penn's avoided costs have not changed.

As the ALJ noted

> West Penn's avoided costs are not at issue in this proceeding. As the court noted in *Milesburg II,* however, it is both consistent and equitable to adjust Mon Valley's capacity rate to reflect the later in-service date.

Quoting the *Milesburg II* decision, the ALJ recognized that West Penn's avoided costs will not change with a change in Shannopin's in-service date. A change in that date will result in a change in the capacity credit; however, West Penn's avoided costs remain constant. In accordance with PURPA, rates are reasonable as long

as they are at or below the full avoided costs of the utility. *American Paper Institute, Inc. v. American Electric Power Service Corp.*, 461 U.S. 402, 418 (1983).

The commission, relying on this court's rulings in *Milesburg*, recognized the dynamic nature of these proceedings, and PURPA's mandate of furthering reliance on national resources, and took appropriate action to ensure that West Penn and Mon Valley's contractual relationship remained alive while the Phase One aspect of the case was in the appeal stage. If the commission had not acted on the modification petition, PURPA's goals would be undermined.

Armco/Allegheny further asserts that subsection (d) of Pa.R.A.P. 1701 does not give the commission jurisdiction pending appeal. That rule provides

> The filing of a petition for review (except a petition relating to a quasijudicial order) shall not affect the power or authority of the government unit to proceed further in the matter, but the government unit shall be subject to any orders entered by the appellate court or by a judge thereof pursuant to this chapter.

Although Armco/Allegheny is correct in asserting that the commission's order constitutes a quasijudicial order, our conclusion that the commission's order maintains the status quo places the action within exception (b)(1) of Pa.R.A.P. 1701 and hence renders subsection (d) inapplicable.

2. *Did the commission have the authority or jurisdiction to issue the emergency and stay orders?*

West Penn argues that the commission lacked jurisdiction to issue the emergency and stay orders which prevented the automatic termination of the original EEPA. West Penn argues that, if the commission had no authority to issue those orders, then the EEPA automatically

terminated when Mon Valley did not meet the good faith deposit deadline.

West Penn presents essentially the same jurisdictional arguments that Armco/Allegheny presented in section 1 of this opinion—that the commission lacked jurisdiction to issue the emergency and stay orders because the commission's approval of the original EEPA was the subject of an appeal to this court at the time Mon Valley filed its modification petition. Thus, West Penn asserts that only this court had jurisdiction over the EEPA at that juncture.

Mon Valley and the commission assert that the emergency and stay orders that prevented termination of the original EEPA during the appeal period maintained the status quo of the contractual relationship between the parties rather than extinguish it. As Mon Valley notes, the commission's emergency and stay orders preserved the relationship and did not alter the contractual obligations.

For the reasons stated above in our discussion of Armco/Allegheny's argument regarding the commission's jurisdiction over the petition for modification, this court concludes that the appeal of the commission's decision relating to the Phase One aspects of this case did not divest the commission of jurisdiction to issue the emergency and stay orders.

Both West Penn and Armco/Allegheny also argue that the commission did not have authority to issue the stay and emergency orders. With regard to emergency orders, the commission's regulation at 52 Pa. Code § 3.7(a) provides that

> A presiding officer may issue an interim emergency order upon finding that the following exist:
>
> (1) The petitioner's right to relief is clear.
>
> (2) The need for relief is immediate.

(3) The injury would be irreparable if relief is not granted.

(4) The relief requested is not injurious to the public interest.

As discussed below in this opinion, this court believes that Mon Valley's right to relief was clear. With regard to the second criterion, need for immediate relief, as Mon Valley points out, if the commission had not issued the order, Mon Valley could have lost its good faith deposits of $120,000 in May and October of 1990.

West Penn argues that monetary loss is not a sufficient reason to issue an emergency order. As Mon Valley and the commission point out, although monetary losses generally are insufficient to support an emergency order, such losses can satisfy the rule's irreparable injury requirement. In this case, if the commission had not issued the order, Mon Valley might have sustained losses, due to no fault of its own, that it would not be able to recover later under any cause of action.

Armco/Allegheny argues in its reply brief that the alleged potential loss is purely speculative because West Penn could return the money to Mon Valley, or the money could be offset in whole or part by a limitation of liability provision in the EEPA. However, in a footnote, Armco/Allegheny also recognizes that the commission could order that the funds be used as an offset to revenue requirements for the benefit of ratepayers in a rate case. Hence, there was a great deal of uncertainty as to whether or not Mon Valley could recover its good faith deposits. Accordingly, this court concludes that the irreparable harm criterion was satisfied.

Finally, the relief the commission granted in the order is not injurious to the public interest.

Both West Penn and Armco/Allegheny argue that no emergency existed which would justify the granting of an emergency order. The commissioner who issued the in-

terim emergency order concluded that an emergency existed, based on his finding that there was a clear and present danger to Mon Valley's property interest in the good faith deposits it had paid at the time it requested the stay, and in the deposits it would have had to pay without the grant of the stay.

In *Peoples Natural Gas v. Public Utility Commission*, 124 Pa. Commonwealth Ct. 59, 555 A.2d 288, 291 (1989), this court, referring to our decision in *Brink's, Inc. v. Pennsylvania Public Utility Commission*, 76 Pa. Commonwealth Ct. 496, 464 A.2d 639 (1983), stated that "[Brinks] held that a finding that economic detriment would result if the temporary grant were not issued did not amount to an "emergency" as a matter of law." However, a review of the *Brinks* case reveals that the court only stated that

> Without ruling on the issue of whether the potential for economic detriment can rise to the level of an "emergency" . . . we observe that *due to the ALJ's failure to conduct an evidentiary hearing, there is no evidence of record to support the ALJ's finding [that an emergency existed]*.

76 Pa. Commonwealth Ct. at 502, 464 A.2d at 641.

Thus, the court in *Brink's* did not hold that economic detriment can never support a finding that an emergency exists. Furthermore, the facts in the *Peoples* decision, upon which West Penn relies, is factually distinguishable. In that case, the economic detriment alleged was "an economic threat of the loss of a proposed plant *expansion*." 124 Pa. Commonwealth Ct. at 65, 555 A.2d at 291 (emphasis in original). This court concludes that the facts in this case supported a finding of an emergency, and that Commissioner Smith properly issued the order and that the commission was correct in affirming the order.

3. *Does the commission have the power to modify EEPAs?*

In *Armco Advanced Materials Corporation v. Public Utility Commission*, 135 Pa. Commonwealth Ct. 15, 579 A.2d 1337 (1990) (*Milesburg II*), this court held that (1) the commission exceeded the authority granted to it under PURPA by calculating the utility's avoided costs (resulting from purchasing energy from a QF) by using a date earlier than the date upon which a legally enforceable obligation was created between the QF and West Penn and (2) the commission had the authority to order a utility to enter a new EEPA after the first contract automatically terminated on the expiration of the contract deadline.

In *Armco Advanced Materials Corporation v. Public Utility Commission*, (No. 2090 and 2097 C.D. 1989, filed September 7, 1990) (*Burgettstown*)[4], this court affirmed the commission's approval of contract modifications that extended the financing closing date of an EEPA and other milestone dates in the EEPA.

West Penn suggests that this court reconsider its decisions in *Milesburg II* and *Burgettstown*. West Penn argues that, by accepting Mon Valley's petition, the commission has, and this court would be affirming, the evisceration of the Federal Energy Regulatory Commission's (FERC) regulations, specifically, 18 C.F.R. § 292.301(b). That regulation provides for two means by which the goal of requiring utilities to purchase energy from cogeneration facilities may be accomplished. The first method involves voluntary negotiations between a QF and a utility, and the second method involves a QF's filing of a petition

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[4] *Burgettstown* is an unreported decision of this court; hence under our internal operating rules parties generally are not permitted to cite such cases or rely upon them in arguments. However, Mon Valley filed a petition with this court for permission to cite *Burgettstown*, which the court granted.

with a state utility commission to compel a utility to purchase energy from the QF.

Specifically, West Penn, citing two decisions from other states, argues that this court should reconsider our *Milesburg II* decision because, otherwise, PURPA's provisions exempting negotiated contracts from PURPA rules must be regarded as meaningless.

In one of the decisions West Penn relies upon, *In re Vicon Recovery Systems,* 572 A.2d 1355 (Vt. 1990), the utility and QF entered into an EEPA which included rates and terms that they agreed to submit to the state utility board for approval. The parties jointly submitted the agreement to the board, which denied the motion, and in a later request for reconsideration, the board specifically disapproved the rate requested and substituted the original EEPA's term of twenty-six years with a thirty-year term.

On appeal to the Vermont Supreme Court, the appellants argued that federal law preempted state regulation of EEPAs and thus precluded the board from exercising jurisdiction over rates contained in EEPAs, and Vermont's equivalent of Pennsylvania's Office of Consumer Advocate argued that the state board did not have authority under Vermont law to reject the rate in the EEPA.

In that case, the Vermont Supreme Court concluded that 18 C.F.R. § 292.304 applies only in situations in which a utility is forced to purchase power from a QF.

This court, however, agrees with Mon Valley that the facts in *Vicon* distinguish it from the present case. Specifically, as Mon Valley notes, Vermont does not require the state board to conduct an evidentiary hearing to determine whether rates proposed in an EEPA exceed avoided costs.

West Penn also relies upon a decision from the Supreme Court of Texas, *Public Utility Commission of Texas v. Gulf States Utilities Co.,* 809 S.W. 2d 201 (Tex. 1991). However, that decision appears to stand only for the prop-

osition that state utility commissions cannot modify the terms of privately negotiated contracts. There is no indication in that opinion that the parties considered the distinction between a privately negotiated contract that the parties elect not to submit to a state utility commission and privately negotiated contracts submitted for approval, as this court recognized in *Milesburg II*.

Furthermore, as Mon Valley notes, in the *Gulf States* decision, the court noted that the applicable law in Texas permits utilities to pass-through rates that are in excess of avoided costs.

As Mon Valley points out, if the commission were to allow utilities to pass through rates in an EEPA, including rates that are in excess of avoided costs, then requiring hearings to enable ratepayers such as Armco/Allegheny to challenge the rates would have no purpose.

West Penn argues that it submitted the EEPA to the commission to obtain approval of pass-through of the avoided cost rates and that in order to collect those rates from its customers, it was *required* to obtain commission approval. However, in the case of a truly privately negotiated contract, the utility could seek recovery in a rate proceeding, rather than seek approval of EEPA rates.

As this court recognized in in *Milesburg II*,

> A utility's submission of its contract with a QF to the PUC for approval is legally equivalent to a petition by the QF to the PUC to compel the utility to enter into that contract . . . The situation is not significantly different from one where a QF simply petitions the PUC to compel a utility to purchase. 579 A.2d at 1348-49.

This court noted that there is a basic distinction between a completely privately negotiated contract and one the utility submits to the commission for approval. In the former case, where the terms of the EEPA are not

subjected to the commission's scrutiny, the utility bears the risk that the commission, in a later rate proceeding, will not approve the utility's request for an increase in rates.

4. *Did modification of the EEPA create a new date of a legally enforceable obligation, thus requiring a new determination of avoided costs?*

West Penn and Armco/Allegheny also argue that, if the commission's modifications are valid, so that the contract did not automatically terminate upon the expiration of the original milestone dates, then a new determination of avoided costs is necessary, because the determinative date of a legally enforceable obligation under the original contract is no longer applicable.

Armco/Allegheny asserts that, if the commission's modifications are upheld, then the court's order, but not its rationale, will be rendered moot because the October 15, 1987 contract and the legally enforceable obligation would no longer exist, i.e., the obligation to deliver power to West Penn under the original contract would be gone. Therefore, Armco/Allegheny argues, under 18 C.F.R. § 292.304(d), it would be improper to recalculate West Penn's avoided costs at the time of the original date the parties signed the contract. Armco/Allegheny contends that the more up-to-date the avoided cost inputs are, the lower the avoided cost rate and charge to ratepayers will be.

Specifically, Armco/Allegheny argues that the use of the original EEPA capacity rate will result in more than $500 million in payments in excess of current avoided cost. Armco/Allegheny relies on the testimony of a West Penn witness which indicates that West Penn does not need Shannopin's capacity "At this particular time" and that therefore, granting the extensions is not in the public interest, a specific requirement of section 210 of PURPA.

According to West Penn's brief, its "current capacity plans call for the construction of low capital cost combustion turbine peaking units in 1999-2000," rather than "the expensive base load capacity sought to be constructed by Mon Valley/CMS Generation." (Brief at 44.) This argument appears to be disingenuous based on West Penn's conduct and the contract it entered with Mon Valley for Shannopin's capacity when it first sought commission approval of the original EEPA.

As Mon Valley points out, the determination of avoided costs in these proceedings was based upon West Penn's need for a 900 MW coal-fired facility comprised of three units that were to come on-line in 1995, 1997 and 1998. *See Shannopin I.*

Mon Valley points to this court's decisions in *Milesburg II*, in which the court held that, where an original EEPA had expired, the legally enforceable obligation existed on the date the original EEPA was signed for the purposes of the modified EEPA the PUC and the court approved, and *Burgettstown*, in which the court directed the commission to calculate Burgettstown's capacity credit based on inputs that were applicable at the time the QF and the utility executed the EEPA.

Indeed, in the *Milesburg* line of cases, the original EEPA forms the basis for the continued obligation on the part of the utility to acquire energy from the QF. As noted in our discussion below, the changes in the EEPA comply with PURPA's requirements and do not represent significant alterations of the original contract terms.

Nevertheless, West Penn, in its reply brief, asserts that this court should not rely on those decisions, arguing that they are distinguishable from the present case, because the Phase One and Phase Two issues in *Milesburg* and *Burgettstown* were reviewed at the same time, whereas, in this case, Mon Valley did not seek modifications until after the conclusion of the Phase One proceedings.

Although West Penn recognizes that at the time of the Phase One proceedings, Mon Valley's significant milestone dates were not as imminent as in the other cases, West Penn argues that Mon Valley should have and could have anticipated that compliance with those dates would be difficult, and therefore, Mon Valley should have requested modifications at the time of the Phase One proceeding.

However, as discussed above, the commission had jurisdiction over this phase of the litigation, and Mon Valley's delay in requesting modifications was not unreasonable.

5. *Do the modifications of the EEPA comply with PURPA's requirements that terms of EEPAs be just and reasonable and in the public interest?*

Armco/Allegheny argues that the modifications are significant. The commission asserts that the modifications of the EEPA are minor and that the extension of the in-service date for the Shannopin project places the date closer to the time West Penn needs the capacity.

With regard to the specific changes in milestone dates, Mon Valley points out that litigation delays forced the change in the financing closing date. Because the other milestone dates in the EEPA are based upon the financing closing date, the commission properly altered those dates to reflect the new financing closing date.

West Penn and Armco/Allegheny object to the extension of the date used as the basis for the capacity rate. The ALJ, relying on this court's decision in *Milesburg II*, as noted above, recognized that West Penn's avoided costs do not change with the extension of the milestone dates. PURPA requires that capacity rates be at or below avoided cost. The later in-service date does change the capacity rate the QF will receive from the utility; however the rate remains consistent with West Penn's avoided

costs. Mon Valley correctly states that the United States Supreme Court has upheld FERC decisions that rates which reflect avoided costs are *per se* just and reasonable and in the public interest. *American Paper Institute, Inc. v. American Electric Power Service Corp.*, 461 U.S. 402 (1983).

Armco/Allegheny contends that the change in financing by increasing the financing term allowed in the contract will result in a substantial increase in ratepayer risk. Armco/Allegheny states that the levelized capacity rate contained in the original contract was based upon the assumption that Shannopin will sell capacity to West Penn over the entire thirty year term of the contract, and if Shannopin is unable to deliver capacity over that period, West Penn's ratepayers will have overpaid for Shannopin's capacity. Under the contract, if Shannopin fails to provide capacity for the term of the contract, it must pay West Penn and its ratepayers "capacity termination costs." Armco/Allegheny notes that West Penn maintains a second mortgage on the power plant to secure its interest in the capacity termination costs, and that with a financing term of twenty rather than fifteen years, there will still be considerable first mortgage debt principal outstanding ahead of West Penn's second mortgage claim for five additional years.

The ALJ concluded that the extension of the financing term "ensures that the EEPA complies with the regulations of the FERC and the goals and provisions of PURPA by reducing the initial principal and interest payments to be made by Mon Valley and thus, facilitating the project in the early stages." (R. 1862a)

That finding is supported by the evidence in the record. The risk that West Penn perceives is speculative, whereas, as the ALJ concluded, adjusting the financing term furthers PURPA's stated objectives of encouraging the use of cogeneration facilities.

Armco/Allegheny also objects to the modification allowing a change in plant ownership, in part because the new ownership "consists primarily of a group of international venture capitalists, foreign business interests, and a subsidiary of a public utility holding company based in Michigan." (Brief at 41)

Although PURPA's goals include the encouragement of reliance upon national resources rather than foreign sources of energy, section 210 has no requirement that utilities enter EEPAs with QFs that are nationally or locally owned. The ALJ and the commission perceived the new ownership as a benefit to the operation of the QF because CMS Generation, a subsidiary of CMS Energy, the Michigan utility company, would assist the project "by providing the financial and technical support of a utility subsidiary." (R. 2032)

Finally, Armco/Allegheny objects to the commission's approval of a change in plant technology. The original EEPA called for the construction of a coal-fired power plant using a circulating fluidized bed boiler. The modification allows the plant to use a pulverized coal boiler and a dry scrubber.

One of Mon Valley's witnesses testified that the use of a pulverized coal burner would be most efficient, would cost less, and would be more reliable. Significantly, West Penn does not object to this modification, but conditioned its agreement upon the right to review the design Mon Valley intends to use in accordance with Article II of the EEPA and upon agreement with Mon Valley on other changes relating to the change in technology.

Based on the testimony supporting the benefits of this change and the fact that the change will facilitate the project, the ALJ and commission properly granted this modification.

6. *Did the commission err in striking the prepared testimony of two of West Penn's witnesses?*

West Penn argues that the commission erred in approving the ALJ's decision to strike the testimony of two of its witnesses. That testimony related to calculations of West Penn's alleged present avoided costs and future capacity needs. West Penn purportedly offered the testimony in support of its position that the modifications do not comply with PURPA's requirement that terms of an EEPA be just and reasonable and in the public interest. West Penn argues that the testimony is relevant to the question of whether Shannopin's capacity is needed in this century. If the capacity is not needed, West Penn contends that acquisition of the capacity is not in the public interest, in violation of PURPA.

This court agrees with the commission that the testimony related to matters within the scope of the Phase One proceeding—determination of avoided costs.

Although the stated purpose of the testimony was to establish the capacity needs of West Penn as of the date West Penn and Mon Valley signed the EEPA, the testimony essentially suggests that West Penn had no need for capacity at that time, a curious contention in light of the fact that West Penn entered the EEPA at that time for the purchase of capacity.

Also, as Mon Valley notes, the ALJ and commission were correct in recognizing that the commission could not address avoided costs—an issue that was the subject of the appeal to this court from the Phase One proceeding.

Finally, Armco/Allegheny argues in its reply brief that there are two reasons why the commission should not have granted the modification petition. The first reason is that the developer should have foreseen the litigation delays and thus bears the risk of those delays. However, that rationale is directly contrary to the reasoning of this court's decisions in *Milesburg II* and *Burgettstown*.

The second reason Armco/Allegheny asserts that the commission should not have granted the modification is because Mon Valley did not pursue certain environmental permitting requirements in a timely manner. Armco/Allegheny alleges that the failure to initiate the permit process two years before the original financing closing date meant that Mon Valley could not have complied with the terms of the EEPA anyway. Of course, there is no certainty that Mon Valley could not have obtained the permits within less than two years. Therefore this court is not persuaded by that argument.

*Conclusion*

In accordance with the above discussion, this court affirms the decision of the commission. The commission had jurisdiction to adjudicate Mon Valley's petition for modification, despite the fact that the Phase One aspect of the case had been appealed to this court.

The commission also had jurisdiction to consider Mon Valley's request for a stay of the good faith deposit requirement and had the authority to issue the emergency order pending review of the full commission.

Under PURPA, the commission had the power to grant the modifications of the EEPA, in accordance with this court's decisions in *Milesburg II* and *Burgettstown*. The modifications did not result in a new contract or a new date of a legally enforceable obligation which would require a new determination of avoided costs. The modifications were in accordance with PURPA's requirement that rates in EEPAs be just and reasonable and in the public interest.

/s/ David W. Craig
DAVID W. CRAIG
President Judge

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

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No. 340 C.D. 1992

WEST PENN POWER COMPANY,
*Petitioner*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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No. 353 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHNEY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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ORDER

NOW, September 3, 1992, the decision of the Pennsylvania Public Utility Commission, dated January 14, 1992, at No. P-880286, is affirmed.

/s/ David W. Craig
DAVID W. CRAIG
President Judge

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

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No. 340 C.D. 1992

WEST PENN POWER COMPANY,
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v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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No. 353 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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Argued: June 17, 1992

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Before: HONORABLE DAVID W. CRAIG, President Judge
HONORABLE JOSEPH T. DOYLE, Judge
HONORABLE BERNARD L. MCGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE DAN PELLEGRINI, Judge
HONORABLE ROCHELLE S. FRIEDMAN, Judge
HONORABLE JAMES R. KELLY, Judge

## DISSENTING OPINION BY JUDGE PELLEGRINI
FILED: September 3, 1992

I respectfully dissent. The PUC should have taken into consideration, before granting Mon Valley's request to modify its negotiated power purchase agreement to extend milestone dates, the PURPA mandate that negotiated purchase agreements by an electric utility from a qualifying co-generator facility be just and reasonable to the ratepayers and in the public interest.

In 1978, Congress enacted the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 796, which requires, *inter alia*, electric utilities to purchase power from certain types of independently owned electric generating facilities (QFs)[1] in order to encourage alternative energy sources. Pursuant to the federal policy of encouraging privately negotiated PURPA agreements, on October 17, 1987, West Penn Power Company (West Penn) and Mon Valley Energy Corporation (Mon Valley) entered into an Electric Energy Purchase Agreement (Purchase Agreement) to take for 35 years up to 80 megawatts of power from an electric-generating facility fueled by coal to be built by Mon Valley. West Penn entered the Purchase Agreement because it projected that it would need the base-load capacity to be supplied by Mon Valley by 1995.

While PURPA does not require PUC approval of these type of agreements, the Purchase Agreement, however, specifically provided that West Penn was under no obligation to purchase power until the Pennsylvania Public Utility Commission approved it and entered a final order beyond appeal that:

- the Purchase Agreement was in compliance with law and public policy;

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[1] A "qualifying co-generation facility" (QF) is an electric power producer that meets minimum operating and efficiency standards, as well as certain ownership criteria. 18 C.F.R. §§ 292.203(b), 292.205, 292.206.

- the purchase of power would not result in excess capacity; [2] and
- the amounts paid by West Penn to purchase the power from Mon Valley could be fully passed on to West Penn ratepayers.

By requiring PUC approval of these conditions, West Penn transferred all risk to its ratepayers that if the power received under this "take or pay" Purchase Agreement was not needed, then the burden to pay for the power would shift on its ratepayers, not its shareholders.

On July 18, 1988, without a hearing, the PUC entered a tentative order approving the Purchase Agreement. Because of our decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*Milesburg I*) requiring a due process hearing before the approval of any agreement to purchase power from co-generation facilities, the PUC withdrew its tentative order. After providing the required hearing, the PUC again entered an order approving the Purchase Agreement. Armco Advanced Metals Corporation and Allegheny Ludlum Corporation (Industrials), two large industrials, both appealed the decision to this court.

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[2] Where the PUC determines that a utility is producing excess capacity, it may exclude the value of the property producing the excess from the rate base and disallow the utility's return on that property. Section 1310(d) of the Public Utility Code, 66 Pa. C.S. § 1310(d), states that:

> Whenever the commission, . . . shall be of the opinion that any rates of such public utility are producing a return in excess of a fair return upon the fair value of the property of such public utility, used and useful in its service, the commission may, by order, prescribe for a trial period of at least six months, . . . temporary rates . . .

"Used and useful in its service" is interpreted by the PUC to mean whether a property's total capacity is commensurate with the requirements for peak demand, plus a reasonable reserve margin relative to the system and obligation. *Pennsylvania Power and Light Company v. Pennsylvania Public Utility Commission*, 101 Pa. Commonwealth Ct. 370, 516 A.2d 426 (1986).

By an unpublished Memorandum Opinion in *Armco Advanced Materials Corporation v. Pennsylvania Public Utility Commission*, (No. 2019 C.D. 1989, filed July 17, 1990) (*Shannopin I*), this court modified the PUC approval by providing that the calculation of capacity costs reflect factors in existence at the time the Purchase Agreement was executed rather than at the time serious negotiations were conducted between the parties. On the same date that we issued our decision in *Shannopin I*, we issued our opinion in *Armco Advanced Materials Corporation v. Pennsylvania Public Utility Commission*, 135 Pa. Commonwealth Ct. 15, 579 A.2d 1337 (1990) (*Milesburg II*), which dealt with that issue, as well as other issues that are relevant here.

Before we issued our decision in *Shannopin I*, Mon Valley filed a Petition for Modification of an Electric Purchase Agreement and a Motion to Enjoin West Penn Power from requiring them to make a good faith deposit as required by the Purchase Agreement. At the hearing before the Administrative Law Judge (ALJ) in 1991, West Penn admitted that it made an error in its 1987 projection that it would need the base load power in 1995.[3] Instead, it now projected that it would only need low cost combustion turbine peaking units sometime in 1999-2000. Finding that the current need for capacity could not be considered because that issue was determined in *Shannopin I*, the ALJ refused to allow into evidence that this capacity was not now needed. The ALJ, however, did recommend granting Mon Valley's request for modifications, as supplemented, as well as a stay from payment by Mon Valley of good faith money to West

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[3] A utility's load is the sum of all customer demands at a given time. "Base load" is the amount of demand that is needed to be met at all times. "Peak load" is the highest point of demand over a period of time, e.g., annual or daily peak load. "Capacity" is the amount of power the utility has available to meet all its needs. See: *Pennsylvania Public Utility Commission Rate Case Handbook*, pp. 12-14.

Penn. The PUC, by order, adopted the ALJ's recommendations. West Penn and the Industrials then filed the instant appeal.

In *Milesburg I*, we decided a hearing was required for PUC approval on purchase power agreements; in *Milesburg II*, we decided that the PUC had the authority to modify negotiated purchase agreements to compensate for litigation delay; and here, we are called upon to decide what limits are placed on the PUC in granting modifications and what factors it has to take into consideration when exercising that authority to modify.

I do not disagree that the PUC can extend milestone dates set forth in a purchase agreement if necessitated by litigation delay to foreclose the purchase agreement to prevent it from lapsing under its own terms. However, I believe that the PUC, when asked to modify an agreement, must also consider if such extensions are in the best interest of ratepayers and the public. PURPA requires that purchase power agreements "be just and reasonable to the electric consumers of the electric utility and in the public interest." 16 U.S.C. § 824-3(B)(1) and 18 C.F.R. § 292.304(a). Unlike what the PUC appears to believe, it does not mandate that QFs be built at all costs.[4]

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[4] I recognize that the purpose of PURPA was to remove barriers erected by utilities to the entry of QFs in the market place. However, Congress did not intend the ratepayers to subsidize their construction or operation. The Conference Committee stated:

> The conference recognizes that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activity generally or on their activities vis-a-vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.
>
> * * *
>
> The provisions of this section are not intended to require the ratepayers of a utility to subsidize cogenerators or small power producers.

H.R. Conf. Rep. No. 95-1750 p. 97-98 (1978); reprinted in 1978 U.S.C.C.A.N. 7831-7832.

West Penn attempted to show before the PUC[5] that modifying the Purchase Agreement was not in the ratepayers' best interest because the 1987 projection that it would need additional base rate power in 1995 that Mon Valley would supply has proven to be erroneous. Because its forecast was erroneous, the avoided costs,[6] upon which the amount West Penn would pay Mon Valley was calculated, was also incorrect. If required to pay that rate for that power, $500,000,000 more in rates would have to be charged to its ratepayers to cover the cost of this unneeded capacity.

The PUC and the majority find that the original purchase agreement forms the basis of the continued obligation on the part of the utility to acquire energy from the QF, even though at the same time allowing alterations for the benefit of the QF to mitigate the effects of litigation delay.[7] This position does not recognize that there is a

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[5] The ALJ struck written testimony of two West Penn witnesses covering West Penn's future capacity needs and avoided costs.

[6] "Avoided costs" means the incremental cost to an electric utility of electric energy or capacity or both, which, but for the purchase from the qualifying facility, such utility would generate itself or purchase from another source. 18 C.F.R. § 292.101(b)(6) (4-1-86).

[7] The majority discounts West Penn's contention that the power is unneeded and excess, finding that "[t]his argument appears to be disingenuous based on West Penn's conduct and contract it entered into with Mon Valley for Shannopin's capacity when it first sought approval [1987] of the original [purchase agreement]." By saying that West Penn is disingenuous for claiming that the base load to be supplied by Mon Valley is not needed, it makes, in effect, a finding without having the benefit of evidence West Penn was precluded from offering to show that this power was not needed, that it is needed. Moreover, rather than lacking in candor, by this statement, West Penn is properly informing the PUC that the passage of time has shown that its projection of expected base capacity demand was erroneous. The majority's statement is like telling a weather reporter that he or she is disingenuous for telling you it's sunny outside when he or she forecast rain yesterday.

third party to these agreements, whose interest under PURPA, must also be protected—the ratepayers. Because the Purchase Agreement is "take or pay", *West Penn ratepayers, not* West Penn, will be forced to pay an additional $500,000,000 in rates for unneeded power.

We have previously held that by bringing the Purchase Agreement before the PUC for modification, the Purchase Ageement became subject to scrutiny to determine if the purposes of PURPA are being fulfilled. In *Milesburg II*, addressing the extent of power that the PUC has to rescue a QF from a bad bargain, and the risk that a utility takes by making a purchase agreement subject to PUC approval to insure that all costs are passed to ratepayers, we stated:

> The question underlying most of the Phase Two issues is the degree to which a QF has the power to bargain away the rights and advantages conferred on it by PURPA, or, conversely, the extent of the power of the PUC to rescue a QF from a bad bargain. Where a utility privately negotiates and executes a contract with a QF, the parties may agree to virtually anything, and the terms of their agreement are legal and enforceable. However, when the utility chooses not to accept the risk that rates it has negotiated will be proper and recoverable, but conditions its obligations on pre-approval by the PUC, then the utility subjects the entire agreement to the scrutiny of the PUC and incurs the risk that the PUC may modify other provisions of the contract if it concludes that they are not in accordance with PURPA and the FERC regulations.

This concept, that by the parties making the Purchase Agreement subject to PUC approval, the utility incurs a risk that the PUC may rescue the QF from its bad bargain, is equally applicable to rescuing the ratepayers from a purchase agreement that is no longer "just and reason-

able" or in the public interest. When the QF requests the PUC to grant modifications to the negotiated Purchase Agreement, it also should similarly incur the risk that the PUC will modify the contract if it finds that the utility made a bad bargain with the QF in calculating the amount of avoided costs and the Purchase Agreement is no longer fair and reasonable to ratepayers as mandated by PURPA. If the PUC can modify a contract to protect a QF from the bad bargain it negotiated for itself, then the PUC can modify a bad bargain for ratepayers, one in which they had no part in negotiating and which they are innocent victims.

I would remand to the PUC to receive evidence as to whether this project will result in excess capacity and if rates negotiated should be modified so that they will be fair and reasonable to the ratepayers.

Dan Pellegrini
DAN PELLEGRINI, Judge

Judge Smith and Judge Friedman join in this dissent.

## APPENDIX D

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

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No. 340 C.D. 1992

WEST PENN POWER COMPANY,
*Petitioner*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

---

No. 353 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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ORDER

NOW, November 10, 1992, having considered the applications for reargument filed by petitioners West Penn and Armco/Allegheny, respondent PUC's answer in opposition and intervenor Mon Valley's answer in opposition, the applications are denied.

BY THE COURT:

/s/ David W. Craig
P. J.

Judge McGinley did not participate in the decision of Armco/Allegheny's application for reargument.

## APPENDIX E

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held July 8, 1988

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice-Chairman
Linda C. Taliaferro
Joseph Rhodes, Jr.
Frank Fischl, dissenting

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Docket Nos. P-880283
P-880284
P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

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## TENTATIVE OPINION AND ORDER

BY THE COMMISSION:

On December 31, 1987, January 5, 1988, and January 20, 1988 West Penn Power Company ("West Penn") filed petitions requesting approval of rate recovery of amounts

paid pursuant to power purchase agreements with the developers of the Monongahela Lock & Dam No. 8 Project ("Monongahela Project"), the Burgettstown Project, and the Shannopin Mine Project, respectively. The Monogahela Project is a proposed 5 MW hydroelectric project located near Point Marion in Fayette County, Pennsylvania, the developer of which is Noah Corporation, a South Carolina corporation. The Burgettstown Project is a proposed 80 MW [1] bituminous coal waste-fired cogeneration plant with two circulating fluidized bed boilers, one steam turbine generator and related facilities to be located in Robinson Township, Washington County, the developer of which is North Branch Energy Partners, L.P., a Delaware limited partnership with offices in Greensburg, Pennsylvania. The general partner of North Branch Energy Partners, L.P. is North Branch Energy, Inc., a Pennsylvania corporation. The Shannopin Mine Project is a proposed 80 MW [2] coal-fired cogeneration plant with a circulating fluidized bed boiler and related facilities to be located at Poland Mines in Greene County, the developer of which is Mon Valley Energy Corporation, a Pennsylvania corporation. As a condition precedent to West Penn's obligation to purchase energy or capacity, each of the three projects must be certified as a qualifying facility ("QF") under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 796(17) through (22) and 16 U.S.C. § 824a-3 (generally "PURPA 210") and the regulations of the Federal Energy Regulatory Commission ("FERC") implementing PURPA 210, 18 C.F.R. § 292.101 *et seq.* All three projects will be located in West Penn's service territory.

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[1] The gross design capacity of the proposed Burgettstown Project will be approximately 91 MW; however the maximum contract output is defined in the power purchase agreement is 80 MW.

[2] The gross design capacity of the purposed Shannopin Mine Project will be approximately 89 MW; however the maximum contract output as defined in the power purchase agreement is 80 MW.

The power purchase agreement governing the Monongahela Project, dated June 15, 1987, provides, *inter alia*, for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after January 1, 1992 and extending the term of the FERC license authorizing the operation of a hydroelectric generating station at the project's site. As a condition precedent to West Penn's obligations under the agreement, such FERC license must be issued no later than January 1, 1990. After the project's commencement date as defined in the agreement, the energy credit for the first fifteen years is 3.8 cents per kwh unless the balance in the tracking account established by the agreement is zero. After the fifteenth year, or during any time that the tracking account balance is zero, the energy credit is a variable equal to 3.8 cents per kwh plus one-half the difference between West Penn's avoided energy costs and 3.8 cents per kwh. The capacity credit is a fixed rate of 3.6 cents per kwh based on a 1992 in-service date of an avoided 300 MW coal plant, and is approximately equivalent to West Penn's estimate as of April 18, 1985 of the levelized present value of avoided capacity over the life of the project.

The power purchase agreement governing the Burgettstown Project, dated October 15, 1987, provides, *inter alia*, for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after September 30, 1991 and extending thirty-three years following the project's commencement date as defined by the agreement. The energy credit is a variable rate based on West Penn's actual production costs at designated generating facilities. The capacity credit is a fixed rate of 3.6 cents per kwh based on a 1995 in-service date of an avoided 300 MW coal plant, and is slightly lower than West Penn's estimate as of October 6, 1986 of the levelized present value of avoided capacity over the life of the project.

The power purchase agreement governing the Shannopin Project, dated October 15, 1987, provides, *inter alia*, for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after August 31, 1992 and extending thirty years following the project's commencement date as defined by the agreement. The energy credit is a variable rate based on West Penn's actual production costs at designated generating facilities. The capacity credit is a fixed rate of 4.0 cents per kwh based on a 1995 in-service date of an avoided 300 MW coal plant, and is slightly lower than West Penn's estimate as of September 1986 of the levelized present value of avoided capacity over the life of the project.

The agreements governing all three projects provide that West Penn will retain a mortgage and security interest in all real and tangible personal property of the projects, and a security interest in all intangible personal property of the projects, subject only to the liens, charges and encumbrances securing the projects' debt or otherwise approved by West Penn.

## WEST PENN'S PETITION

West Penn avers that its voluntary entrance into the three transactions was made "in complete reliance on its well-founded belief that doing so is in furtherance of federal laws and policy and of the laws and public policy of the Commonwealth of Pennsylvania, and that such actions will not in and of themselves now or in the future create circumstances which result in the imposition of penalties, restrictions or other adverse circumstances on West Penn and its investors and ratepayers." Petitions of West Penn, pp. 7, 5-6, and 6, respectively. West Penn also avers that the capacity credits to be paid to the Monongahela, Burgettstown and Shannopin Mine Projects are less than the capacity credits that may have been calculated under the Commission's own regulations implementing PURPA 210 at 52 Pa. Code §§ 57.31 *et seq.* Petitions of West Penn at pp. 4.

Conditions precedent to West Penn's obligations under the power purchase agreements are final Commission Orders satisfactory to West Penn allowing West Penn a full and timely pass through to its ratepayers of all charges paid by West Penn under the agreements. West Penn also requests that the Commission provide for a public notice and comment period regarding such rate treatment for due process reasons and to foreclose possible future collateral attacks on the Commission's Orders. West Penn states that it will not voluntarily enter into the three power purchase agreements absent such public notice and comment period. Finally, although not part of the formal relief requested by West Penn, West Penn submits that, in view of the excess capacity provisions of Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, the Commission's Orders should encompass a finding that the entrance by West Penn into the power purchase agreements does not result in excess capacity under Section 1323 as to the capacity of the projects themselves or as to any *existing* West Penn capacity.

## RESPONSIVE PLEADINGS TO WEST PENN'S PETITION

Several pleadings in response to West Penn's petitions have been filed with the Commission. On January 20, 1988 the Office of Consumer Advocate ("OCA") filed an Answer to West Penn's petition pertaining to the Monongahela Project. OCA takes no position at this time regarding the avoided cost calculation which forms the basis for the proposed power purchase agreement and rate treatment. OCA objects to "any contract approval which contains the type of excess capacity protective language sought by West Penn in Paragraph 14 of its Petition." OCA Answer, p. 2. OCA notes that all but one of West Penn's prior contracts with qualifying facilities have been approved without this protective language as have the contracts of all of the other utilities in the Commonwealth.

OCA notes that the only prior Commission Order granting this relief, *Petition of West Penn Power Company Re Milesburg Energy, Inc.*, P-870216 (September 22, 1987), was appealed by OCA to the Commonwealth Court, the Petition for Review pending at No. 2418 C.D. 1987. OCA therefore urges that the Commission *not* grant the protective language regarding an excess capacity determination under Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323.

On January 25, 1988 OCA filed an Answer to West Penn's petition pertaining to the Burgettstown Project. In addition to a request that the Commission not include any protective language regarding Section 1323 in its Order, OCA submits that the Commission should not approve the contract until West Penn has demonstrated, through hearings, the propriety of the capacity credits to be paid under the power purchase agreement with the developer of the Burgettstown Project. In support of its request for hearings, OCA notes that West Penn's petition does not indicate what supply and demand forecasts were used by West Penn in connection with the Burgettstown Project. OCA's concern in this case is "to ensure that West Penn has not overstated its need for capacity and thus agreed to excessive capacity payments.' OCA Answer, p. 4. In particular, OCA questions West Penn's projections of a need (now avoided) for a new coal plant in the fourth quarter of 1995.

On Febraury 3, 1988 OCA filed an Answer to West Penn's petition pertaining to the Shannopin Mine Project that essentially is identical to its Answer to West Penn's petition pertaining to the Burgettstown Project. OCA also requests that the two proceedings be consolidated for hearings in view of the identity of issues and in the interest of administrative economy.

On January 20, January 21, and February 3, 1988 Airco Industrial Gases ("Airco") filed Petitions to Intervene in the Monongahela, Burgettstown, and Shannopin

Mine proceedings respectively. Airco avers that it is a large, energy intensive industrial customer of West Penn, and that it has a vital interest in the Commission's determination of the issues in these proceedings. Airco did not file an Answer to any of the West Penn petitions.

On January 26, January 25, and February 8, 1988 Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny") filed Petitions to Intervene in the Monongahela, Burgettstown, and Shannopin Mine proceedings, respectively. Armco/Allegheny aver that they are large manufacturers and processors of steel products and ratepayers of West Penn, and that they have a vital interest in the Commission's determination of the issues in these proceedings. Armco/Allegheny did *not* file an Answer to West Penn's petition pertaining to the Monongahela Project. Armco/Allegheny did, however, file Answers to West Penn's petitions pertaining to the Burgettstown and Shannopin Mine Projects. Armco/Allegheny aver, *inter alia*, that the capacity credits to be paid for energy produced by the Burgettstown and Shannopin Mine Projects are excessive, essentially because in Armco/Allegheny's opinion West Penn does not need the capacity of a coal plant in 1995. Armco/Allegheny's averment is based on a perception that West Penn underestimated its generation supply and overestimated its reserve margin in projecting a need for a 1995 coal plant. In particular, Armco/Allegheny refer to a recent five-year contract between Allegheny Power System ("APS") and the Old Dominion Electric Cooperative ("ODEC") for the sale of 300 MW of capacity, the existence of the Springdale and Mitchell units in cold reserve, and the availability of power from the Ohio Valley Electric Cooperative as support for their averments concerning generation supply. With regard to West Penn's reserve margin, Armco/Allegheny aver that West Penn based its calculation of the capacity credits offered to the Burgettstown and Shannopin Mine Projects on a 25-31% margin, which Armco/Allegheny aver should be

lower "because West Penn's generating units have become more reliable in recent years." Answers, pp. 8 and 10, respectively. Finally, Armco/Allegheny aver some legal conclusions concerning the calculation of capacity credits, the payment of capacity credits prior to the in-service date of avoided capacity, the applicability to the projects of Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, the requirement that the Commission hold a hearing on West Penn's petitions, and the Commission's previous "determination" at P-870216 that the proposed addition of 43 MW from the Milesburg Project would fully satisfy West Penn's capacity needs. Armco/Allegheny request that the Burgettstown and Shannopin Mine Projects be considered together.

On January 26, 1988 North Branch Energy Partners, L.P. ("North Branch"), the developer of the Burgettstown Project, filed a Petition to Intervene in the proceeding at P-880284 and Statement in Support of West Penn's petition. North Branch avers, *inter alia*, that the use of bituminous refuse by the Burgettstown Project will solve an environmental problem that has long plagued industry and the Commonwealth, will conserve depletable fuels, and will produce carbon dioxide that can be used by other industrial concerns. Approximately 200-300 jobs will be created during the construction period and approximately 50 persons will be employed on a permanent basis. North Branch further avers that the rates established by the power purchase agreement are just and reasonable, will not exceed the present value of West Penn's avoided costs over the term of the agreement, and are less than those that would be required by the Commission's regulations implementing PURPA 210 at 52 Pa. Code §§ 57.31 *et seq*. North Branch cites prior Commission decisions for the propositions that a QF is entitled to a known stream of payments based on the utility's avoided costs, even if the costs avoided would not occur until sometime in the future, and that the avoided costs that are utilized are

those projected as of the date the QF offers to accept capacity credits based on the construction costs of a plant to which the utility is committed. Finally, North Branch joins in West Penn's request for a public comment period although it avers it needs prompt action on West Penn's petition to finance and construct the plant.

On February 9, 1988 Mon Valley Energy Corporation ("Mon Valley"), the developer of the Shannopin Mine Project, filed a Petition to Intervene in the proceeding at Docket No. P-880286. Mon Valley avers, *inter alia*, that the Shannopin Mine Project will use approximately 250,000 tons per year of high sulphur coal mined in the Commonwealth, that approximately 450 jobs will be created in the 24-30 month construction period, that 50-60 persons will be employed permanently to operate the facility, and that Shannopin Mining Company will need to employ approximately 20 additional persons in order to supply coal to the facility. On February 19, 1988 Mon Valley filed a Statement in Support of West Penn's Petition. Mon Valley avers that the rates to be paid for power produced by the Shannopin Mine Project are just and reasonable because the rates do not exceed the present value of West Penn's avoided costs over the term of the agreement, and the capacity credits are lower than those that might have been calculated under the Commission's regulations. Mon Valley further avers that it has assumed all risk associated with construction and operation of the Project, and that West Penn's interest in the Project is protected by various terms to the agreement. Mon Valley avers that the Project will be environmentally beneficial because in excess of 90% of the sulphur oxide emissions will be removed through advanced pollution control technology, and because low combustion temperatures will minimize the formation of nitrous oxides. Finally, Mon Valley avers that the cogenerated steam will be sold to Shannopin Mining Company for the purpose of drying coal, thereby improving the coal's quality and making Shannopin's future

coal sales more competitive with foreign and out-of-state coal.

In addition to formal pleadings in the form of Petitions to Intervene and Answers to West Penn's petitions, several governmental agencies and private entities have filed letters with the Commission expressing their views concerning the various projects. On January 21, 1988 the Western Pennsylvania Conservancy filed a letter in support of the Burgettstown Project. The Conservancy states that it is the largest private land conservation organization in Pennsylvania, with the purpose of conserving water, land and wildlife. The Conservancy believes the Burgettstown Project will convert waste land, with ongoing pollution problems, into a clean, economically productive use. In particular, the Conservancy states that the Project's site is the former Consolidation Coal Company's Champion 518 acre coal waste facility that was operated for over 40 years and that consists of pits and valleys filled with waste from deep and strip coal mines. Today the present owner, Bologna Coal Company, operates several treatment ponds that handle extensive acid mine drainage from the waste piles. The Conservancy states that erosion is severe, that high winds create choking dust from loose coal particles, and that aesthetically the site looks like the underside of the moon. The Conservancy notes that the technology to be utilized by the Project controls $SO_2$ and $NO_x$ emissions without expensive and sometimes unreliable flue gas desulpherization equipment; that the Project meets all EPA and DER ambient air quality standards; that most of the waste water will be recycled; that sludges and solids will be disposed of in an approved aerated sewage package system; and that the end result of the project is reclaimed land capable of attracting industrial and commercial development.

On February 1, 1988 the Executive Director of the Redevelopment Authority of Washington County ("Authority") filed a letter in support of the Burgettstown Proj-

ect. The Authority urges the Commission's favorable action on the Project, noting that the Robinson Township area in Washington County is very economically distressed and is in great need of jobs and private investment. The Authority states that the Burgettstown Project represents an investment of $150 million, 200-300 construction jobs, 50-60 full-time permanent jobs, the reclamation of approximately 1,000 acres through the utilization of approximately 38 million tons of bituminous coal waste, and a very favorable potential for future development at the project's site at the intersection of U.S. Route 22 and State Route 980.

On February 1, 1988 the Group for Recycling in Pennsylvania, Inc. ("GRIP"), a nonprofit citizen group dedicated to the conservation of nautral resources and energy, filed a letter endorsing the Burgettstown Project for its creative and environmentally sound approach to cogeneration. GRIP avers that the operation of the Burgettstown Project will reduce the impact of acid run off and particulate dispersion by eliminating gob piles and slurry ponds, thereby enhancing the quality of the environment. GRIP requests the Commission's full consideration of West Penn's petition at P-880284.

On February 22, 1988 Northwest Economic and Employment Development, Inc. ("NEED"), a non-profit regional economic development corporation, filed a letter in support of the Burgettstown Project. NEED avers that the Burgettstown Project is absolutely essential to the future well-being and development of northwest Washington County for various reasons. In particular, NEED avers that (1) West Penn Water Company has proposed a badly needed regional water system for Northwest Washington County, the economic feasibility of which depends upon the construction of the Burgettstown Project; (2) the area's future economic development depends on the development of a public water system, the catalyst for which would be the Burgettstown Project; (3) the Project will create approximately 200 construction jobs and 50-60

permanent jobs in an area of high unemployment; (4) the Project would consume huge unsightly gob piles at the site and in their place create usable land for development at a prime location on an interchange of the Route 22 corridor; and (5) useful, low-cost electricity will be created from the waste and ravages of the past, thus creating value where there is none, and conserving other valuable resources.

On February 22, 1988 the Cross Creek Valley Regional Planning Commission filed a letter in support of the Burgettstown Project. The Commission states that the plan of the Western Pennsylvania Water Co. to supply water to the northern portion of Washington County is contingent upon the development of the Burgettstown Project; that the Project will provide many badly needed jobs in the area; and that utilization of the gob pile for fuel will remove an eyesore and be environmentally helpful.

On February 25, 1988 the Robinson Township Board of Supervisors filed a letter in support of the Burgettstown Project. The Board of Supervisors states that the Project will transform a vast wasteland of coal refuse, lagoons and ravines left over from coal mining into an area that can be developed for commercial or industrial uses in a prime location at Route 980 and U.S. Route 22; that the Project's creation of over 200 construction jobs and 50-60 permanent jobs could be the seed that will provide growth and development in the township; and that the area is in need of public water and sewage systems, which would accompany the construction of the Project.

On February 25, 1988 the Board of Commissioners of Washington County filed a letter in support of the Burgettstown Project. The Board of Commissioners states that the Project is compatible with the goals of economic development, environmental improvement, resource conservation, and future land use for economic development.

In particular, the Commissioners refer to the creation of approximately 200 construction jobs and 50-60 permanent jobs; the extension of public water service to several thousand persons; the utilization of unsightly gob piles; and the region's economic decline, lost population, high unemployment and decreasing property values.

On February 29, 1988 the Supervisors of Smith Township, Washington County, filed a letter in support of the Burgettstown Project. The Supervisors state that due to the high unemployment in the area the Project would be a welcome uplift, and that eliminating the unsightly gob piles to produce good usable land, low cost electricity, and steam for future use would be a great asset.

On March 1, 1988 the Board of Supervisors of Hanover Township, Washington County filed a letter in support of the Burgettstown Project. The Board states that the Project would provide construction jobs as well as full-time jobs upon completion; would play an important role in revitalization of the area; would eliminate a long-standing environmental problem in the area; and would reclaim land capable of attracting industrial and commercial development in neighboring Robinson Township.

On May 9, 1988 the Dunkard Township Supervisors filed a letter in support of the Shannopin Mine Project. The Supervisors state that the Project will help secure the jobs of 225 Shannopin Mining Company employees, will employ 450 persons during construction, and upon completion will employ 50 permanent employees and provide new business for local suppliers. The Supervisors state that the Project will provide a much needed increase in tax revenues for Dunkard Township.

On May 9, 1988 the Board of Commissioners of Greene County filed a letter in support of the Shannopin Mine Project. The Board of Commissioners states that the Project will help secure the jobs of the current Shannopin Mining Company employees, will generate new

jobs, and will use the best technology for burning coal, which will reduce emissions below federal and state standards. It is the Board's hope that the technology will be forerunner of future fossil fuel power plants in Pennsylvania that will assure the coal industry of a long term market.

On May 10, May 12 and 27, 1988, respectively, Lee Supply Co. Inc., Local 6159 of the United Mineworkers of America and Sandvik Rock Tools, Inc. filed letters in support of the Shannopin Project. All three letters express support based on the same considerations expressed by the Greene County Board of Commissioners.

On May 16, 1988 the Greene County Association of Township Supervisors filed a letter stating that the Association had unanimously passed a resolution endorsing the Shannopin Mine Project. The Association states that the Project will help secure the jobs of 225 Shannopin Mining Company employees, will employ 450 persons during construction, and upon completion will employ 50 permanent employees and provide new business for local suppliers. The Association notes that Greene County has the highest unemployment rate in the state.

REPLIES TO THE RESPONSIVE PLEADINGS:

West Penn filed replies to OCA's Answers to the Petitions governing the Monongahela, Burgettstown and Shannopin Projects on February 11, February 16, and February 26, 1988, respectively. West Penn's Reply to OCA's Answer to the Monongahela Petition denies that the requested § 1323 protective language was not included in all but one of the Commission's Orders approving prior power purchase agreements between West Penn and various QFs. With respect to the Commission's Orders at P-840563 and C-844022, West Penn avers that the § 1323 protective language was unnecessary because the Commission's Orders predated Act 114 of 1986, which added § 1323 to the Public Utility Code. With

respect to the Commission's Orders at P-860165 and P-840563 (approval of modification of previously-approved capacity and energy credits), it is West Penn's position "that while the Commission declined West Penn's request for positive answers to West Penn's questions concerning Section 1323, by approving the agreements the Commission implicity made a determination that the agreements were in accord with the Pennsylvania Public Utility Code, including Section 1323." Reply, p. 2. In response to OCA's averment that the Commission's Order at P-870216 went even further than West Penn's request (by excluding the Milesburg capacity from excess capacity determinations with respect to *any* generating units during the terms of the contract, as opposed to *existing* generating units), West Penn agrees that QF capacity should be taken into account with regard to the generation it is designed to delay or avoid. Reply, p. 3.

West Penn's Replies to OCA's Answers to the Burgettstown and Shannopin Petitions respond to OCA's concern that West Penn may have overstated its need for capacity by stating, *inter alia,* as follows:

> . . . West Penn submits that the pricing for the Milesburg Project [approved by the Commission by Order entered September 22, 1987 at Docket No. P-870216] was established by West Penn and Milesburg Energy, Inc. on May 8, 1986 and that the pricing between West Penn and North Branch Energy Partners, L.P., for the Burgettstown Project [and Mon Valley Energy Corporation for the Shannopin Mine Project] was established on October 6, 1986 [and September 10, 1986, respectively]. The Commission has recognized that for agreements under Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA 210), pricing terms should be locked in as of the date the pricing is established. *See* Commission Order in Allegheny Lock and Dam #5 at Docket No. P-860165, en-

> tered January 7, 1987. At the time the pricing for the Milesburg Project [,] . . . the Burgettstown Project [, and the Shannopin Mine Project] were established the relevant portions of West Penn's generation plan were the same.
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> The generation plan indicated that, for planning purposes, to avoid West Penn's reserve margin falling below the minimally acceptable 25% level, additional generating capacity would be needed in 1995. To accomplish this, a three-unit station, with each unit being 300 megawatts, was planned with the units coming in service in 1995, 1997 and 1998. Under the PURPA 210 agreements, . . . the Milesburg Project[,] . . . the Burgettstown Project [, and the Shannopin Mine Project] pricing were based upon avoiding a portion of the same station. Hence, the generation plan that supported [the] Milesburg Project also supports the Burgettstown Project [and the Shannopin Mine Project]. Although the decision is now on appeal, the Commission did approve the avoided capacity payments for the Milesburg Project. Further, at the time the Burgettstown Project [and the Shannopin Mine Project] pricing was established, the Commission had already approved, after adversary hearings, West Penn's planning capacity reserve margin at Docket No. R-842632 (Order entered August 28, 1985) and had originally affirmed the same at Docket No. R-850220 (Order entered July 25, 1986). Moreover, a methodology of utilizing future needed capacity as a basis for determining avoided capacity costs for PURPA 210 is included in the Commission's own regulations governing PURPA at 52 Pa. Code § 57.31, *et seq.*

West Penn's Replies to OCA's Answers, pp. 1-3. West Penn further avers that the combined effect of all planned PURPA 210 projects contributes to the delay of West Penn capacity, and that the issue of the appropriateness

of West Penn's reserve capacity margin at the time in question does not require a hearing since the issue had already been decided by the Commission at Docket Nos. R-842632 and R-850220. With respect to OCA's position on the relief requested by West Penn vis-a-vis Section 1323, West Penn's Replies reiterate its Reply to OCA's Answer to the Monongahela Petition, *supra*.

West Penn also filed Replies to the Answers to Armco/Allegheny to the Petitions governing the Burgettstown and Shannopin Projects on February 16 and March 2, 1988, respectively. West Penn, *inter alia*, states that Armco/Allegheny's comparison of the proposed QF agreements to the recent contract between APS and ODEC is neither revelant nor meaningful. The contract with ODEC is limited to a term not exceeding seven years, while the Burgettstown and Shannopin agreements are based, pursuant to PURPA 210, upon the present worth of future avoided or delayed capacity levelized over a period of 33 and 30 years, respectively. Moreover, West Penn submits that the avoided capacity costs for the Burgettstown and Shannopin Projects were based on a planned three-unit power station, the first unit of which was projected to come on line in 1995, at which time the ODEC transaction will be concluded. West Penn also denies Armco/Allegheny's allegation that the Burgettstown and Shannopin Projects represent non-firm capacity. Answers, pp. 3-5.

With respect to Armco/Allegheny's allegation that West Penn improperly failed to account for the 361 MW Springdale and Mitchell units in cold reserve, West Penn submits that Armco/Allegheny mistakenly assumed that West Penn's avoided cost calculations were based on the new coal-fired capacity being on-line prior to the reactivization of the Springdale and Mitchell units. West Penn avers that, under the generation plan in effect at the time price agreement with Burgettstown and Shannopin was reached, the Mitchell and Springdale units

were planned to come on-line in March 1992 and March 1993, prior to the avoided capacity on which the Burgettstown and Shannopin capacity payments are based. Although West Penn's current plans include reactivization of the units in 1998 and 1999, West Penn states that Armco/Allegheny fail to distinguish between the generation plan in effect at the time price agreement with the QFs was reached and the current generation plan. West Penn submits that "under its current generation planning, the Mitchell No. 1 and 2 and the Springdale units are planned to be reactivated in 1998 and 1999, and the plan does not include any new West Penn owned generating capacity until *after* Mitchell Nos. 1 and 2 and the Springdale units are reactivated." Replies of West Penn, pp. 6 (emphasis supplied). West Penn admits that the units can be made operational to provide *peaking* capacity.

With respect to Armco/Allegheny's allegation that the capacity credits to be paid for power produced by the Burgettstown and Shannopin Mine Projects are excessive because West Penn did not factor into its calculation the availability of power from the Ohio Valley Electric Cooperative ("OVEC"), West Penn states that, on the basis of official current projections by the federal Department of Energy ("DOE"), for planning purposes it must be assumed that no OVEC capacity will be available to West Penn after October 1988.[3]

With respect to Armco/Allegheny's allegation that the proposed capacity credits are excessive because they were

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[3] West Penn is a sponsoring company of OVEC, which has generating stations with a net demonstrated capability of approximately 2,300 MW. OVEC supplies the power needs of DOE's gaseous diffusion plant located near Portsmouth Ohio, which produces fuel for domestic and foreign nuclear power plants. All OVEC generating capacity unneeded by DOE is made available to the sponsoring companies. West Penn's current cost of power from OVEC is about 1.7 cents per kwh for entitlement power and less for additional temporary power.

based on an excessive reserve margin of 25-31%, West Penn states that the 1995 in-service date of the first unit of the planned three-unit coal station, on which the capacity credits were based, was the date at which West Penn projected that its planning reserve magrin would fall below 25%. At the time the capacity credits were agreed upon, in September and October 1986, the Commission had approved West Penn's planning reserve margin at Docket No. R-842632, and had affirmed the same at Docket No. R-850220. West Penn admits that, in general, its generating unit availability has increased in recent years, but avers that the extent of long-term improvement to availability was not determined by September/October 1986, when the pricing agreements governing the Burgettstown and Shannopin Mine Projects were established. In response to Armco/Allegheny's averment that various parties to the proceeding on remand at Docket No. 850220 had argued for a reserve margin lower than 25%, West Penn states that this case was finalized by a Commission Order entered February 12, 1988 that adopted a settlement agreement among the parties to the proceeding, and that the Commission made no specific finding as to generating reserves.

With respect to Armco/Allegheny's legal argument concerning the levelization of capacity credits, and the applicability of Section 1323(a) to qualifying facilities, West Penn responds that the Commission's regulations at 52 Pa. Code § 57.31 *et seq.*, set forth a methodology of utilizing future capacity needs as a basis for determining capacity credits; that the timing differences between the in-service dates of the Projects and the avoided capacity is accounted for by West Penn's methodology for determining capacity credits; and that as to West Penn, purchases from qualifying facilities constitute purchased power. With respect to Armco/Allegheny's legal argument concerning due process requirements, West Penn responds that due process does not necesasrily require a full evidentiary hearing for approval of the instant Peti-

tions. Further it is West Penn's position that the reserve capacity margin issue was fully litigated by Armco/Allegheny at Docket Nos. R-842632 and R-850220 for the time period relevant to the instant proceedings, and that due process would not require a further full evidentiary hearing on this issue. With respect to Armco/Allegheny's reference to language in the Commission's Order approving the agreement between West Penn and Milesburg Energy, Inc. (wherein the Commission stated, *inter alia*, that additional QFs could be considered as excessive, and that future agreements would be closely scrutinized), West Penn avers that the pricing for the Milesburg, Burgettstown and Shannopin Mine Projects were based on the same generation plan, and that the pricing for all three projects were based upon avoiding a portion of the same generating unit, e.g., the first of three 300 MW coal units planned for 1995, 1997 and 1998. Hence, the generation plan that supported the Milesburg Project also supports the Burgettstown and Shannopin Mine Project pricing. Finally, West Penn states that, if the Commission elects to hold hearings in the instant proceedings, it would not object to Armco/Allegheny's request that the Projects be considered together. West Penn also incorporates by reference relevant portions of the transcript at Docket Nos. R-842632 and R-850220.

North Branch filed a Response to the Answer of Armco/Allegheny to West Penn's Petition pertaining to the Burgettstown Project on February 16, 1988. North Branch avers that, in 1984, Energy Management Associates ("EMA") conducted a Reserve Margin Study for West Penn that found that a prudent reserve margin for West Penn would be 25 to 37% over winter peak; that the study was the subject of a hearing before the Commission; that West Penn's witnesses who testified in support of the study were cross-examined by Armco/Allegheny; and that the Commission ultimately found that West Penn's "planning reserve range of 25 to 31% is reasonable." North Branch cites *Pa.P.U.C. v. West*

*Penn Power Co.*, 69 PUR 4th 470 at 489 (1985). North Branch also avers that the Allegheny Power System Generation Capacity Plan dated October 1, 1985, which was filed with the Commission as part of West Penn's annual Capacity Planning Report on April 29, 1985, and which is attached as Exhibit 6 to North Branch's Response, showed a need to construct a new plant comprised of three 300 MW coal plants to meet demand by October 1995; and that in a proceeding in which West Penn presented testimony and Armco/Allegheny cross-examined witnesses, the Commission found that the 1985 Capacity Plan was reasonable. North Branch cites *Pa.P.U.C. v. West Penn Power Co.*, 77 PUR 4th 220 at 244 (1987). North Branch further avers that it began negotiations with West Penn in July 1985 and that the parties reached price agreement in October 1986 based on the 1984 Reserve Margin Study and the 1985 Capacity Plan. North Branch avers that it has expended in excess of $2.1 million in planning, design, engineering and legal fees to insure that the Project can be placed in-service by October, 1991. North Branch avers that the capacity credit of 3.6 cents per kwh is slightly less than West Penn's internal calculation of avoided cost, and 1.25 cents per kwh less than West Penn's avoided costs calculated in accordance with the Commission's regulations at 52 Pa. Code § 57.34(c). In addition to the arguments/averments made by West Penn, North Branch describes the proposed fluidized bed technology as commercially mature and points out that, if the technology were deficient, it would be North Branch that would bear the risk of nonperformance, as opposed to West Penn or its ratepayers. North Branch projects annual savings of over $7 million in 1991 dollars to West Penn's ratepayers attributable to the Burgettstown Project when compared to the payments that would be required pursuant to the Commission's regulations. With regard to Armco/Allegheny's assertion that the Burgettstown capacity is unneeded due to the "return" of West Penn's 135 MW share of the ODEC power by 1995, at the latest, North Branch

points out that the APS projections set forth in the 1985 Capacity Plan do not anticipate this load ever leaving the system, yet a need for new capacity was anticipated by October 1995. North Branch states that the Commission repeatedly has held that a qualifying facility is entitled to a known stream of payments based upon estimates of a utility's avoided costs as of the date the qualifying facility accepts capacity credits based on the construction costs of a plant to which the utility is committed, citing *AES Beaver Valley, Inc. v. West Penn Power Co.*, Docket No. C-844022 (Order entered October 10, 1986). With respect to Armco/Allegheny's averments concerning the Springdale and Mitchell units, North Branch notes that the 1985 Capacity Plan shows reactivation in 1992 and 1993, and that even with the then-projected reactivation, the Capacity Plan shows a need for new capacity in 1995. North Branch avers that the Springdale and Mitchell plants are old, peaking units and do not have 33 years of remaining life. "The ability of the cogeneration plant to come on-line in 1991 provides a benefit to West Penn's ratepayers by eliminating the need to reactivate old oil-fired units solely for peaking purposes which have a limited life and which burn a fuel whose costs are both high and extremely volatile. Instead, North Branch provides ratepayers with a reliable, efficient fixed-cost base load unit." North Branch Response, p. 18. With respect to Armco/Allegheny's arguments concerning OVEC capacity, North Branch avers that DOE has requested OVEC to submit to it a proposal to extend the existing DOE-OVEC agreement through 2005. North Branch attached as Exhibits 7 and 8 to their Response the APS-OVEC Power Agreement of July 27, 1987 and a "Message from the President" of OVEC dated April 15, 1987 stating *inter alia*, that DOE has made a request to extend the agreement through 2005. North Branch avers that it would be irresponsible for West Penn to assume for planning purposes that DOE will not take any further power from OVEC after 1992. With respect to Armco/Allegheny's

legal argument that a levelized capacity credit in general is improper, North Branch notes that both the Commission's and the Federal Energy Regulatory Commission's ("FERC") regulations implementing PURPA 210 sanction the levelization of rates paid to QFs. North Branch also notes that the capacity credit it will receive has been greatly reduced due to the timing difference between its anticipated 1991 on-line date and the 1995 projected need for capacity, and that if the facility were to come on-line in 1995, the capacity credit would be substantially higher, resulting in increased costs to ratepayers. With respect to Armco/Allegheny's legal arguments pertaining to the excess capacity provision found at Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, North Branch responds that the Section 1323's definition of excess capacity is merely a rebuttable presumption, as opposed to an inflexible rule, and that Act 114 of 1986 contained several provisions in addition to Section 1323 designed to encourage qualifying facilities. North Branch also refers to the Commission's proposed policy statement on the treatment of qualifying facilities in excess capacity determinations, published at 17 *Pa.B.* 3035 (July 18, 1987, and the Commission's Order in *Petition of West Penn Power Co. Re Milesburg Energy, Inc.*, Docket No. R-870216 (September 22, 1987) as authority for the proposition that the capacity represented by the Burgettstown Project would not be included in an excess capacity determination with respect to West Penn's existing generating units. North Branch states that inclusion of capacity from qualifying facilities in excess capacity determinations with respect to existing utility units would in effect penalize the utility for complying with federal law, a result not permitted under the Supremacy Clause of the U.S. Constitution. In response to Armco/Allegheny's legal argument concerning due process, North Branch avers that the instant proceeding constitutes a rate decrease, as opposed to an increase, and that Armco/Allegheny have not cited any authority for the proposition that a due process right

to a hearing attaches when rates are decreased. North Branch asserts that the only variables at issue in calculating the appropriate capacity credit are the proper reserve margin and the date the avoided unit would be needed:

> With respect to these two issues [Armco/Allegheny] have been afforded two full hearings with the right to cross-examine witnesses and present witnesses of their own. They claim initially that the 1984 Reserve Margin Study of EMA is flawed. That study has been the subject of two proceedings before the Commission and has been found to be reasonable by the Commission. *See* 69 PUR 4th 470 at 489. Next [Armco/Allegheny] claim that the 1985 Capacity Plan is erroneous. That plan has also been approved by this Commission after a hearing in which [Armco/Allegheny] participated, cross-examined witnesses and presented rebuttal testimony. *See* 77 PUR 4th 220 at 244.
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> Calculation of a proper capacity credit in this case is merely ministerial once a reserve study and a capacity generation plan have been validated and approved by the Commission. No other component of the calculation has been questioned by [Armco/Allegheny]. [Armco/Allegheny] are not really requesting a due process hearing but in fact are requesting a second or perhaps third bite at the apple since they were unsuccessful in the other proceedings.

North Branch Response, pp. 28-29. Finally, North Branch disputes Armco/Allegheny's reliance on dicta contained in the Commission's order approving the agreement between West Penn and Milesburg Energy, Inc. by stating that the computation of the capacity credits for the Milesburg and Burgettstown Projects were made on the same basis. North Branch avers that the 1985 Capacity Plan utilizes a yearly increase in demand forecasts of less than 2%, and that should demand increase at a greater rate, West Penn would require additional capacity prior to 1995.

North Branch also filed a Response to the Answer of OCA to West Penn's Petition pertaining to the Burgettstown Project on February 16, 1988. North Branch incorporates by reference paragraphs 1 through 14 of its Response to Armco/Allegheny's Answer. In addition, North Branch avers that OCA as well as Armco/Allegheny was a party to the proceedings in which the 1984 Energy Management Associates Reserve Margin Study and the 1985 Generation Capacity Plan were approved by the Commission. North Branch incorporates by reference relevant provisions from its Response to Armco/Allegheny regarding the dicta contained in the Commission's Milesburg Order; the appropriate planning reserves; the 1985 Capacity Plan; and the excess capacity protection sought by West Penn. In conclusion, North Branch asserts that OCA's request for further hearings on the 1984 Reserve Study and the 1985 Capacity Plan can be viewed only as an attempt to kill the Burgettstown and similar projects, and that OCA apparently would prefer subjecting ratepayers to the risks involved when utilities construct large power plants rather than allowing the risk of escalating costs to be shifted to private developers.

Mon Valley filed Responses to the Answers of Armco/Allegheny and OCA to West Penn's Petition pertaining to the Shannopin Mine Project on March 2 and February 25, 1988, respectively. Mon Valley disagrees with Armco/Allegheny's statement that the circulating fluidized bed boiler and related technology entails a high design risk. Mon Valley avers that the technology is commercially available from several manufacturers including Pyropower, Combustion Engineering, Riley Stoker, Babcock and Wilcox, and Keeler Dorr Oliver, and that a substantial number of units are in service. Mon Valley avers that the levelization of payments to developers of QFs is in compliance with PURPA and the Public Utility Code and that the excess capacity protective language sought by West Penn is consistent with the Commission's proposed policy state-

ment on the issue and with Act 114 of 1986. Finally, Mon Valley concurs with OCA and Armco/Allegheny's request to consolidate the proceedings pertaining to the Burgettstown and Shannopin Mine Projects. In addition, Mon Valley requests that the proceeding involving the Monongahela Lock and Dam No. 8 Project be consolidated as well since all three proceedings involve common questions of law and fact.

The final responsive pleading filed in the three above-captioned proceedings is Armco/Allegheny's Reply to the Response of North Branch to Armco/Allegheny's Answer to West Penn's Petition pertaining to the Burgettstown Project, filed on March 10, 1988. Generally, Armco/Allegheny state that the rationale underlying North Branch's Response ignores the current realities on the West Penn system. Utilizing various sources of information, Armco/Allegheny aver that West Penn currently has more than sufficient capacity to satisfy its customers' requirements, and that the excess capacity situation will not be alleviated in the near future. Essentially, Armco/Allegheny dispute the proposition that the reasonableness of capacity credits are to be based upon estimates of a utility's avoided costs as of the date the qualifying facility accepts capacity credits based upon the construction costs of a plant to which the utility is committed. Armco/Allegheny's position is that all events that occur between the date of price agreement and the date of the Commission's decision must be considered when evaluating the agreement. Armco/Allegheny aver that North Branch contradicts itself by referring to West Penn's Exhibit 2, which is the utility's analysis of the Value of Generating Capacity to be provided by the Burgettstown Project, and which is dated December 8, 1987. Other than this legal argument, the balance of Armco/Allegheny's pleading is essentially a restatement of its factual assertions regarding the ODEC sale, and the existence of the Springdale and Mitchell Units. Two factual assertions raised for the first time are,

first, a reference to an APS Analysis of Generating Units prepared in November 1982 (attached as Exhibit 8 to Armco/Allegheny's Reply) that concludes, *inter alia*, that there is an economic incentive to pursue the conversion of the 207 MW Springdale unit to coal. Armco/Allegheny argue that West Penn's avoided costs should be based on the Springdale unit, as opposed to a new 300 coal unit. The second factual assertion raised for the first time is a reference to a document under protective order at Docket No. R-850220 (the Bath County Reconsideration). Armco/Allegheny state that the document casts doubt upon certain assertions made by North Branch and West Penn, and that West Penn has refused to allow the document into the record of the instant proceeding.

## WEST PENN'S MOTION FOR A PROTECTIVE ORDER

On March 24, 1988 West Penn filed a Motion for a Protective Order in the proceeding pertaining to the Burgettstown Project at Docket No. P-880284. West Penn avers that, in the hearings at Docket R-850220 (Bath County reconsideration) ALJ Klovekorn issued an order on September 15, 1987 sealing a certain document marked as Armco/Allegheny Ludlum Cross Examination Exhibit No. 1. ALJ Klovekorn's bench order was as follows:

> Hearing the discussion of the parties, I agree with the Company that Armco-Allegheny Ludlum Cross Examination Exhibit No. 1 contains proprietary information which had best be kept under seal and separate from the other documents in this proceeding.
>
> I will direct the court reporter to seal this document, and I would direct the parties that if they refer to this material in their brief, that it shall be done in a special proprietary brief separate and apart from the public brief in this matter. And I'll direct the parties

> —I will remind the parties that in view of the proprietary nature of this exhibit it should not be disseminated to persons or organizations other than parties to this proceeding.

N.T. at 1518, Docket No. R-850220.

In addition to sealing the document, ALJ Klovekorn also sealed the cross-examination testimony relating to the document at N.T. pp. 1538 through 1547.

West Penn avers that Armco/Allegheny's attorney contacted West Penn several days prior to March 10, 1988 and sought permission to disclose certain information set forth in the sealed exhibit, which West Penn refused. West Penn avers that Armco/Allegheny's Reply to the Response of North Branch ("Reply"), filed March 10, 1988, disclosed some of the confidential information. West Penn requests that the Commission enter an Order striking Armco/Allegheny's Reply, requiring that the original and all copies of the Reply be returned to the Commission to be destroyed, and prohibiting any further disclosure of the information set forth in certain paragraphs of the Reply.

On March 31, 1988 Armco/Allegheny filed a Memorandum in Opposition to West Penn's Motion for a Protective Order. Armco/Allegheny aver that its Reply was worded carefully so as not to reveal any proprietary information, and that no specific factual information was disclosed at all.

## DISCUSSION

1. *Analysis of Proposed Capacity Credits.*

As a preliminary matter, we will grant the Petitions to Intervene as filed by Airco, Armco/Allegheny, North Branch and Mon Valley. All of these entities have an interest in the proceedings that is not adequately represented by any other party. See 52 Pa. Code § 5.72.

Because West Penn's Petitions and the various pleadings filed in response thereto raise common issues of fact and law, we have determined that it would be more efficient to consider the proceedings together rather than separately. Therefore, we will consolidate the three proceedings for the purpose of discussion and disposition.

The three projects that are the subject of the instant proceeding are qualifying facilities ("QFs") under Section 201 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Act Nov. 9, 1978, P.L. 95-617, Title II, § 201, 92 Stat. 3134, codified at 16 U.S.C. § 796 (17) through (22). Pursuant to Section 210 of PURPA, codified at 16 U.S.C. § 824a-3, West Penn is required by law to purchase the power produced by the three projects at a price equal to West Penn's full avoided costs as defined by PURPA and the regulations thereunder at 18 C.F.R. § 292.304(b)(2) and 52 Pa. Code § 57.34. The U.S. Supreme Court upheld the full avoided cost rule in 1983. *American Paper Institute v. American Electric Power Service*, 461 U.S. 402 (1983).

In addition to our regulation setting forth the methodology for the calculation of a utility's full avoided costs, *supra.*, our regulations provide that utilities and QFs are free to negotiate contracts that provide for the payment of rates below those that otherwise would be required. 52 Pa. Code § 57.32(c). Consistent with our past practice, we will grant West Penn's requests for rate recovery approval if the agreements with the developers of the Monongahela, Burgettstown and Shannopin Mine Projects provide for rates that are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the proposed rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers.[4]

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[4] *See Petition of Pennsylvania Electric Company Re Scrubgrass Power Corp.*, Docket No. P-870248 (January 21, 1988) for a dis-

Therefore, the only factual issue to be resolved in the instant proceeding is whether the proposed rates are at or below West Penn's full avoided costs as defined by PURPA 210 and the regulations thereunder.

West Penn's Exhibits 2 to its three Petitions set forth the calculation of the capacity credits to be paid for power purchased from the Monongahela, Burgettstown and Shannopin Mine Projects. Exhibit 2 to the Petition pertaining to the Monongahela Projects identifies mid-1985 as the "date of decision," or price agreement. The date that additional capacity is needed (coal plant start date) is identified as the latter part of 1992. Exhibit 2 to the Petition pertaining to the Burgettstown Project identifies the date of decision as October 6, 1986 and the date that additional capacity is needed (coal plant start date) as the latter part of 1995. Exhibit 2 to the Petition pertaining to the Shannopin Mine Project identifies the date of decision as September 10, 1986 and the coal plant start date as the latter part of 1995.

Although there are many extraneous issues raised by the various pleadings in these proceedings, the heart of the matter really is whether West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law.

It is well settled that the time period that controls evaluation of projections of avoided costs is the time during which negotiations between the utility and the QF occur. *See* Preamble to 18 C.F.R. § 292.101 *et seq.*, 45 *Fed. Reg.* 12224 (February 25, 1980); 52 Pa. Code § 57.34(c)(1); *Petition of West Pen Power Company Re Allegheny Lock and Dam No. 6*, Docket No. P-840563 (January 7, 1987); *AES Beaver Valley Inc. v. West Penn Power Company*, Docket No. C-844022 (October 10, 1986). As demonstrated by West Penn's Ex-

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**cussion of the Commission's policy regarding rate recovery of amounts paid for power generated by QFs.**

hibits 2, *supra*, price agreement with the developers of the Burgettstown and Shannopin Mine Projects was reached in October and September, 1986, respectively. The negotiated capacity credits were based on a need projected at that time for additional capacity in 1995. Therefore, with respect to the Burgettstown and Shannopin Mine Projects, the question before the Commission is whether West Penn's 1986 projected need for capacity in 1995 was reasonable during the period of contract negotiations in 1986. With respect to the Monongahela Project, the question is whether West Penn's projected need for capacity in 1992 was reasonable during the period of contract negotiations prior to the price agreement of April 1985.

Pursuant to 52 Pa. Code § 57.33, all electric utilities in Pennsylvania are required to file system cost data on an annual basis in order "[t]o make available data from which energy or energy and capacity credits may be derived." 52 Pa. Code § 57.33(b)(1). These filings, commonly referred to as "avoided cost filings" include information concerning the utility's plans for the addition of plant during the current and each of the next ten (10) years. 52 Pa. Code § 57.33(b)(1)(ii) and (iii). West Penn's plans for the addition of three (3) 300 MW future coal plants have been incorporated into West Penn's avoided cost filings since at least July 1984, or during all relevant periods in question. West Penn's avoided cost filing of July 31, 1984 identified the addition of the coal units in 1992, 1994 and 1996. The in-service dates of the coal units have been steadily deferred, in part due to the inclusion of QF capacity in West Penn's capacity plans. Thus, West Penn's July 1985 avoided cost filing identified the in-service dates as 1992, 1994 and 1997. West Penn's July 1986 avoided cost filing identified the in-service dates as 1995, 1997 and 1998.[5]

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[5] West Penn's most recent avoided cost filing of July 1987, which is not relevant to the instant proceeding, identifies the in-service dates as 2000, 2001 and 2004.

During the period following the effective date of our regulations implementing PURPA 210, or since January 10, 1983, the Commission has approved four (4) agreements between West Penn and the developers of four qualifying facilities in the following proceedings:

1. *Petition of West Penn Power Re AES Beaver Valley*, Docket No. P-844022 (January 24, 1985 and October 10, 1986) (115 MW cogeneration facility).

2. *Petition of West Penn Power Re Allegheny Lock and Dam No. 6*, Docket No. P-840563 (April 19, 1985 and January 7, 1987) (9 MW small power production facility).

3. *Petition of West Penn Power Re Allegheny Lock and Dam No. 5*, Docket No. P-860165 (January 7, 1987) (8 MW small power production facility).

4. *Petition of West Pen Power Re Milesburg Energy, Inc.*, Docket No. P-870216 (September 22, 1987).

All four agreements approved by the Commission provided for the payment of a capacity credit based upon West Penn's projected need for the series of three (3) 300 MW coal units at some point in the future. The capacity credit of 3.4 cents (later modified to adjust for inflation) to be paid to AES Beaver Valley was based on the 1992 coal plant (negotiated in 1984)[6], the capacity credit of 3.6 cents to be paid to Allegheny Lock and Dam No. 6 was based on the 1992 coal plant (negotiated in 1984)[7]; the capacity credit of 3.5 cents to be paid to Al-

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[6] See Exhibit 2 to West Penn's Petition filed September 4, 1984.

[7] See West Penn's Petition filed October 15, 1986 at p. 5 and Exhibit 6 thereto.

legheny Lock and Dam No. 5 was based on the 1992 coal plant [8] (negotiated in 1984); and the capacity credit of 3.3 cents to be paid to Milesburg Energy Inc. was based on the 1995 coal plant [9] (negotiated in 1986). Thus, the Commission routinely has approved West Penn agreements providing for the payment of capacity credits based on the three (3) future 300 MW coal units. In the instant proceedings, the capacity credit of 3.6 cents proposed to be paid for power produced by the Monongahela Project was negotiated in early 1985 and was based on the 1992 coal plant; and the capacity credits of 3.6 cents and 4.0 cents proposed to be paid to the Burgettstown and Shannopin Mine Projects, respectively, were negotiated in 1986 and were based on the 1995 coal plant. The proposed capacity credits therefore are based on the same capacity addition plans upon which the previously-approved credits were based, *supra*. Although the Commission's prior sanction, in effect, of West Penn's capacity addition plans as a proper basis for the calculation of capacity credits may not be conclusive, it weighs heavily in favor of the granting of West Penn's Petitions in the instant proceeding. In particular, the capacity credits proposed to be paid to the Burgettstown and Shannopin Mine Projects were negotiated during the same period and were based upon the same capacity addition plans as the previously-approved capacity credits to be paid to Milesburg Energy, Inc. The capacity credit proposed to be paid to the Monongahela Project was based on the same capacity addition plan as the previously-approved capacity credits to be paid to the AES Beaver Valley, Allegheny Lock and Dam No. 6 and Allegheny Lock and Dam No. 5 Projects, *supra*.

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[8] See West Penn's Petition filed October 15, 1986 and Exhibit 2 thereto.

[9] See West Penn's Petition filed April 2, 1987 and Exhibit 2 thereto.

As West Penn notes in its Replies to OCA's Answers to the Petitions pertaining to the Burgettstown and Shannopin Mine Projects, West Penn's 1986 capacity addition plan, which indicated a need for additional capacity in 1995, was based on a reserve margin of 25%. As noted by West Penn, the Commission approved West Penn's planning capacity reserve margin of 25% by Orders entered on August 28, 1985 and July 25, 1986 at Docket Nos. R-842632 and R-850220, respectively. Both of these Orders were entered after full evidentiary hearings in the context of general rate increase proceedings addressing, generally, the Bath County Pumped Storage Unit. OCA, Airco, and Armco/Allegheny were parties to the proceeding at R-850220, *Pa. P.U.C. et al. v. West Penn Power*.[10] In that proceeding, we found, in relevant part, as follows:

> In the prior rate proceeding at Docket No. 842632, we first determined that the Company's reserve margin, with a range of 25%-31% and an optimum of 28%, was reasonable. We then set forth the reserve margins as shown in Column A above . . . [West Penn's Annual Capacity Planning Report filed April 29, 1986] presents a similar pattern, except that there is a one year lag. Thus, the coming winter, 1986-87, is considerably above the 25%-31% range. Within two years, however, it reaches the top of that range, 31% in the winter of 1988-89, and in one more year, it reaches the optimum, 28% in the winter of 1989-90.
>
> In short, essentially the same forecasts and planning which we found reasonable in the prior proceeding are again before us in the instant proceeding, and we again find them reasonable.

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[10] Airco participated as a member of the West Penn Power Industrial Intervenors ("WPPII"); Armco/Allegheny participated jointly under the designation of the Large Power Industrial Intervenors ("LII").

*Pa. P.U.C. et al. v. West Penn Power,* Docket No. R-850220 (July 25, 1986) at pp. 42-44.[11]

That fact that we have on two prior occasions found, after fully litigated proceedings, that the optimum reserves margin for West Penn is 28%, with a range of 25 to 31%, adds further support to West Penn's capacity addition plans upon which the capacity credits in the instant proceeding were based. As stated above, West Penn's projected need for the future three (3) 300 MW coal units was based on a planning reserve of 25%, which is *lower* than the optimum of 28% as determined by the Commission, and at the lowest end of the range of 25% to 31% that was found to be reasonable.

Under our regulations, the payment of a capacity credit is required if a utility is forecasted to need additional capacity within a ten-year period. 52 Pa. Code § 57.34(c)(4)(iii). Utilizing West Penn's Annual Capacity Planning Report filed on April 29, 1986 pursuant to 52 Pa. Code § 57.49 ("1986 I.D. 138 filing"),[12] the following reserve margins can be projected by utilizing the projections of operable resources and peak demand:

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[11] By Order entered April 17, 1987, we granted WPPII's Petition to Reopen Record and granted in part the petitions for reconsideration filed by WPPII and OCA in light of 66 Pa. C.S. § 1323(a). On January 12, 1988 the various parties filed a Settlement Agreement with the Administrative Law Judge ("ALJ"). The ALJ's Recommended Decision to approve the Settlement Agreement was adopted by the Commission by Order entered February 12, 1988. Pursuant to the settlement, all parties agreed to dismiss, withdraw and discontinue with prejudice all proceedings relating to the legality or propriety of the inclusion of Bath County costs in rates.

[12] In the Bath County rate proceeding at Docket No. R-850220, *supra*, the Commission took official notice of the 1986 I.D. 138 filing. Opinion and Order, p. 41. WPPII supported the Trial Staff's motion for official notice. West Penn has incorporated relevant portions of the transcript at R-850220 into the record of the instant proceeding.

| Year | Operable Resources (MW)* | Peak Demand (MW) | Reserve Margin (%)** |
|---|---|---|---|
| 1986/87 | 3780 | 2720 | 28.04 |
| 1987/88 | 3709 | 2776 | 25.16 |
| 1988/89 | 3687 | 2821 | 23.49 |
| 1989/90 | 3685 | 2869 | 22.14 |
| 1990/91 | 3680 | 2912 | 20.87 |
| 1991/92 | 3776 | 2961 | 19.45 |
| 1992/93 | 3744 | 3004 | 19.76 |
| 1993/94 | 3835 | 3043 | 20.65 |
| 1994/95 | 3830 | 3084 | 19.48 |
| 1995/96 | 3962 | 3121 | 21.23 |

* Net Capability + Scheduled Imports—Scheduled Exports—Inoperable Capability

** Does not include Scheduled Outages

Source: Form 138-B.

Utilizing the previously determined reserve margin of 25%-31% and the reserve margins projected by West Penn during the period in question demonstrates that West Penn was projected to need additional capacity in 1995.[13] Therefore, the payment of capacity credits to QFs would be required pursuant to the Commission's regulations. Generally, West Penn's methodology for calculating capacity credits results in a more conservative (lower) credit than would result from the application of the methodology set forth in our regulations. Consequently, the negotiated capacity credits proposed to be paid to the Burgettstown and Shannopin Mine Projects are lower than those that would be required by law absent the voluntary agreements under consideration. Because the proposed rates are lower than those that could have been required, the rates are *per se* reasonable and automatically are recoverable from ratepayers. Therefore, it would appear that West Penn's petitions for rate recovery approval must be granted.

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[13] In fact, it would appear that, in 1986, West Penn was projecting a need for additional capacity by 1988/89. Although it is not necessary to make this determination in the instant proceeding, such a determination would support the payment of full, rather than discounted, capacity credits to Burgettstown and Shannopin.

Turning now to the various pleadings filed in response to West Penn's petitions, we will address the various issues pertaining to the appropriateness of the credits in the following paragraphs.

First, with respect to OCA's and Armco/Allegheny's request for evidentiary hearings, we note that the projected need for capacity depends in large part upon the determination of a utility's appropriate reserve margin. That determination having been made, as discussed above, we see no reason for further evidentiary hearings in order relitigate the issue. Moreover, if we were to require an evidentiary hearing in all proceedings involving utility-QF agreements, we are concerned that the time and expense involved would severely hamper the continued development of cost effective cogeneration and small power production in the Commonwealth. A simple reference to the saga of the proceedings addressing the Bath County Project, which addressed a plant that was *completed* and the issue of West Penn's appropriate reserve margins and the reserve margins projected in the near future, is an indication of the potential complexity of a proceeding involving a utility-QF agreement, which could involve projections of reserve margins up to ten years into the future. Unlike a utility, a QF typically is project-financed, which means that a project typically will not be able to bear the expense and time involved in what essentially could be a complex rate proceeding.

FERC recognized the dangers of requiring evidentiary hearings on a case-by-case basis at the federal level in an analogous situation. On the issue of whether FERC's interconnect rules should require QFs to go through the complex procedures set forth in the Federal Power Act, FERC found that:

> [T]o require qualifying facilities to go through the complex procedures set forth in . . . the Federal Power Act to gain interconnection would, in most circumstances, significantly frustrate the achievement

> of the benefits of this program. . . . The Commission believes that accomplishment of this purpose [of providing a market for QFs] would be greatly hindered if it were to require qualifying facilities to utilize . . . the Federal Power Act as the exclusive means of obtaining interconnection. It therefore concludes that such a restrictive interpretation of the laws is not supportable.

45 *Fed. Reg.* 12222 (February 25, 1980). FERC's final regulations therefore required electric utilities to make interconnections to qualifying facilities upon request. 18 C.F.R. § 292.303(c). In reviewing and approving FERC's interconnect rule, the U.S. Supreme Court stated as follows:

> The purposes of [PURPA 210] make it most unlikely that Congress could have intended that an evidentiary hearing be held for every interconnection necessary to consummate a purchase or sale of electricity authorized by the Act. Evidentiary hearings under . . . the FPA entail a determination of whether a proposed interconnection (1) is in the public interest, and (2) would encourage overall conservation of energy or capital, optimize the efficiency of use of facilities and resources, or improve the reliability of the affected utility systems. It is highly doubtful that Congress could have intended that the Commission make such a determination every time a qualifying facility seeks to hook up with a utility to complete a purchase or sale under PURPA. . . .
>
> *Providing an opportunity for evidentiary hearings before the Commission for every interconnection necessary to complete a purchase or sale under PURPA would seriously impede the very development of cogeneration and small power production that Congress sought to facilitate.* Many of the facilities in question are small operations. By definition a small power production facility has a produc-

> tion capacity of no more than 80 megawatts, and cogeneration facilities may also be of modest size. Many owners of qualifying facilities would have little incentive to purchase or sell electric energy if they had to go through an evidentiary hearing before FERC in Washington, D.C., every time they needed to hook up with a utility to consummate a purchase or sale. . . . If we were to hold that utilities must be provided an opportunity for a hearing whenever a qualifying facility seeks an interconnection in order to effectuate a purchase or sale under PURPA, we would be 'imput[ing] to Congress a purpose to paralyze with one hand what it sought to promote with the other.

*American Paper Institute v. American Electric Power Service Corp.*, 461 U.S. 402, 419-421 (1983) (citations omitted) (emphasis supplied).

Although we may, where necessary and appropriate, exercise our discretion in specific proceedings involving utility-QF agreements and order evidentiary proceedings, there is no requirement in administrative proceedings that the opportunity to be heard take place before an administrative law judge. "The essential requirements of due process . . . are notice and an opportunity to respond. The opportunity to present reasons, either in person *or in writing*, why proposed action should not be taken is a fundamental due process requirement." *Cleveland Board of Education v. Loudermill*, 470 U.S. 532 (1985) (emphasis supplied). The U.S. Supreme Court in *Loudermill* cited Friendly, "Some Kind of Hearing," 123 U. Pa. L. Rev. 1267 (1975) for the proposition that something less than a full evidentiary hearing is sufficient due process prior to administrative actions. *See: Northwestern Indiana Telephone Co. v. Federal Communications Commission*, 824 F.2d 1205 (D.C. Cir. 1987).

In the instant proceeding, we are considering proposed payments to three QFs that are mandated by law. West

Penn does not have the discretion to refuse to purchase the output of the Monongahela, Burgettstown and Shannopin Mine Projects. The only factual issue involved is whether or not the proposed payments are at or below West Penn's avoided costs as defined by law. In view of the fact that (1) West Penn's plans for the addition of three (3) 300 MW coal plants have been included in all of West Penn's avoided cost filings during 1984-1986; (2) West Penn's generation plans formed the basis for four previously-approved agreements with QFs; and (2) the appropriate reserve margin for West Penn has been established during the relevant time period after full adversarial hearing, we decline to exercise our discretion to order an evidentiary hearing.[14]

Armco/Allegheny raised several specific issues regarding West Penn's capacity situation. With respect to the five-year contract between Allegheny Power System ("APS") and the Old Dominion Electric Cooperative ("ODEC") for the sale of 300 MW of capacity, we agree with West Penn that a comparison of the proposed QF agreements to the APS/ODEC contract is neither relevant nor meaningful. The contract with ODEC is limited to a term not exceeding seven years, while the pricing agreements with the QFs are based, pursuant to PURPA 210, upon the present worth of future avoided or delayed capacity. Moreover, the pricing under the APS/ODEC agreement was based primarily on embedded costs, which are irrelevant to a determination of the capacity credits to be paid to a qualifying facility. FERC addressed this point by stating that "[t]he utility's avoided incremental costs (and not average system costs) should

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[14] Armco/Allegheny's reference to dicta at pp. 6-7 of our Order approving the West Penn-Milesburg agreement is misplaced. This dicta, which stated that agreements filed by West Penn subsequent to the agreement with Milesburg would be scrutinized closely by the Commission, does not constitute a finding on any issue, and certainly does not constitute a determination that the addition of Milesburg would fully satisfy West Penn's capacity needs.

be used to calculate avoided costs. With regard to capacity, if a purchase from a qualifying facility permits the utility to avoid the addition of new capacity, then *the avoided cost of new capacity and not the average embeded system cost of capacity should be used.*" 45 *Fed. Reg.* 12216 (February 25, 1980) (emphasis supplied). Therefore, Armco/Allegheny's argument on this point has no merit and is rejected. With respect to Armco/Allegheny's averments concerning the Springdale and Mitchell units in cold reserve, we note that, under the generation plan in effect at the time price agreement with Burgettstown and Shannopin was reached, the Mitchell and Springdale units were planned to come on-line in March 1992 and March 1993, prior to the avoided capacity upon which the proposed capacity credits were based. We agree with West Penn that Armco/Allegheny fail to distinguish between the generation plan in effect at the time price agreement was reached and the current generation plan. As previously discussed, the generation plan in effect at the time of price negotiations or agreement is controlling. Moreover, we note that the Springdale and Mitchell units can be made operational to provide *peaking* capacity, while the three QFs under consideration are designed to defer or avoid needed baseload capacity. Therefore, a comparison of the proposed capacity credits to the costs of reactivating the Springdale and Mitchell units is inappropriate. With respect to Armco/Allegheny's averment that West Penn's previously determined appropriate reserve margin should be lowered "because West Penn's generating units have become more reliable in recent years," we note that, as discussed extensively above, the generation plan in effect at the time of price negotiations or agreement is controlling and the Commission previously determined in 1985 and 1986 that a reserve margin of 25% to 31% was appropriate. We decline to reopen this issue to consider events that may have occurred since 1985 and 1986. With respect to Armco/Allegheny's averments that West Penn should

have in essence, relied upon the possibility that power from the Ohio Valley Electric Cooperative would be available in the future to West Penn, we reject the notion that a utility should rely upon chance for capacity planning purposes. West Penn's obligation to serve would not permit it to rely upon mere speculation when planning its future capacity additions or purchases. West Penn states that, on the basis of official current projections by DOE, for planning purposes it must be assumed that no OVEC capacity will be available to West Penn after October 1988.

2. *Rate levelization.*

Armco/Allegheny again have objected to levelization of rates generally. This issue was raised in the proceeding involving Milesburg Energy, Inc. and rejected by our Order of September 22, 1987. Essentially, Armco/Allegheny's objection is based upon timing differences between West Penn's projected need for capacity and the projected on-line date of the QFs. This argument is very similar to the "ratepayer avoided cost" and "utility avoided cost" argument that we consistently have rejected since 1985. *AES Beaver Valley v. West Penn Power,* Docket No. C-844022 (March 13, 1985); *Petition of West Penn Power Re Allegheny Lock and Dam No. 5,* Docket No. P-860165 (January 7, 1987) at pp. 7-8; *Petition of West Penn Power Re Allegheny Lock and Dam No. 6,* Docket No. P-840563 (January 7, 1987) at p. 5.

Neither FERC's nor this Commission's regulations implementing PURPA 210 require a matching of rates to avoided costs at the time of delivery. FERC's regulations specifically provide that " '[i]n the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subject if the rates for such purchases differ from avoided costs at the time of delivery." 18 C.F.R.

§ 292.304(b)(5). *See* 45 *Fed. Reg.* 12224 (February 25, 1980). In fact, when we promulgated our regulations at 52 Pa. Code § 57.31 *et seq.*, we specifically rejected a suggestion for a capacity credit methodology that would have tracked the declining revenue requirement that would be associated with a utility-owned base load unit under traditional regulation. *Implementation of the Public Utility Regulatory Policies Act of 1978*, Docket No. L-810060 (1982), as published at 12 *Pa.B.* 4239 (December 11, 1982). Levelization of capacity credits in fact contributes to solving the intergenerational inequity problem under traditional regulation, where the revenue requirement associated with a new utility unit is highest in the early years of operation when the plant is likely to be needed least.

Our regulations, as well as West Penn's internal methodology, fully account for timing differences by discounting the capacity credit to be paid to a QF when that QF is expected on-line prior to the time that a utility is projected to need capacity. In simpler terms, the proposed capacity credits have been lowered to account for the timing difference between the QFs' anticipated on-line dates and the 1995 coal plant.

This issue having been addressed on many prior occasions, we reject Armco/Allegheny's argument.

3. *Section 1323 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 1323.*

West Penn has requested protective language finding that the entrance by West Penn into the proposed power purchase agreements will not result in excess capacity under Section 1323 as to the capacity of the projects themselves or as to any existing West Penn capacity. OCA has requested that the Commission not include the requested finding in any order it may issue. Armco/Allegheny argue that QF capacity itself is subject to a Section

1323(a) analysis, and that West Penn has asked for a declaration that "if the company builds a new generating facility any time within the next 30 years, the Commission will ignore the capacity from the Shannopin project when determining whether the new West Penn plant is needed." Armco/Allegheny's Answer, p. 14.

As a preliminary matter, we note that Armco/Allegheny have mistinterpreted the scope of the relief sought by West Penn. West Penn essentially has asked only that it not be penalized with regard to its *existing* units by virtue of its agreement to purchase power produced by the Monongahela, Burgettstown and Shannopin Mine Projects. It has not, as averred by Armco/Allegheny, requested that the QF capacity be excluded from a Section 1323(a) excess capacity analysis of units that West Penn may be build in the *future*. This clarification aside, the Section 1323 issue was raised and fully addressed in the Commission's Order approving the rates proposed to be paid to Milesburg Energy, Inc., *supra*. In the Milesburg proceeding, we followed our proposed policy statement on the treatment of qualifying facilities in excess capacity determinations that was published at 17 *Pa.B.* 3035 (July 18, 1987). Our Order in the Milesburg stated as follows:

> Consistent with the Commission's current thinking as expressed in the proposed "Policy Statement on the Treatment of Qualifying Facilities in Excess Capacity Determinations" . . . it is proper that the relief requested by West Penn be granted. In the proposed statement of policy, the Commission held that in most cases it is both appropriate and consistent with the legislative intent to exclude QF capacity in excess capacity/reserve calculations pursuant to Section 1323 —the exception being where a utility purchases long-term QF capacity and subsequently fails to defer or cancel planned construction of its own generation.

Opinion and Order, p. 6. Our holding therefore excluded the QF capacity from an excess capacity determination for

West Penn's existing capacity. The holding would permit inclusion of QF capacity in excess capacity determinations for future West Penn capacity additions. From a policy perspective, this result is sound because it requires West Penn to consider QF capacity in its capacity addition plans. From a legal perspective, we interpret Section 1323 as permitting the result reached by our proposed policy statement and applied in the Milesburg proceeding. Section 1323(c) provides that, in some specific instances, the Commission is precluded from considering QFs in determining the reasonable reserve margin and economic benefits associated with a new utility-owned base load generating unit. This provision expressly prohibits the Commission from exercising its otherwise flexible limit of judgment in matters concerning ratemaking in specific situations. In cases not governed by Section 1323(c), we have retained our flexibility to consider QFS in a manner based on our sound judgment on areas of ratemaking. In fact, the limited Section 1323(c) exemption, which pertains only to older utility plant placed in service prior to July 1985, already is largely irrelevant. There are no electric base load units placed in service prior to July 1985 that have not already been scrutinized by the Commission in a base rate proceeding. West Penn's Bath County Project, which was under consideration at the time the instant petitions were filed, reached commercial operation in December 1985. The 1323(a) analysis of Bath County has been resolved by a settlement agreement approved by a Commission Order of February 12, 1988 at R-850220.

In addition to the specific exemption governing pre-July 1985 utility plants, Section 1323(c) also preserves the Commission's pre-existing authority, which permits the Commission to weigh all factors in an appropriate manner in determining whether a utility's plant meets the used and useful criteria in an excess capacity analysis.

In addition to their arguments concerning Section 1323 (c) and the inclusion of QF capacity in a capacity de-

termination with respect to utility-owned plant, Armco/Allegheny also argue that QF capacity itself triggers a Section 1323(a) excess capacity analysis. We disagree. Our interpretation of Section 1323(a) is that it applies only to utility-owned generating units. The disallowances set forth therein simply do not apply to power purchase agreements, such as the ones at hand, where the utility recovers its expenditures on a dollar for dollar basis. West Penn acts merely as a conduit for the collection of amounts paid to qualifying facilities, and does not earn a return or a profit on any aspect of its power purchase agreements. Thus, the disallowances set forth in Section 1323(a), which require a disallowance of a return *on* excess capacity or the equity investment in a unit, have no applicability to purchases of power from QFs. The Commission's additional authority under 1323(a) to "disallow any other costs of the unit or units which the Commission deems appropriate" should not be read as applicable to rates required under PURPA 210. Because utility/QF agreements nearly always provide for the levelization of rates, as *required* by our regulations, it would be extremely difficult for many QF projects designed to provide long-term cost savings to the utility and its consumers to meet the reasonable reserve margin and net economic benefits tests set forth in Section 1323 (a) if these tests were strictly applied and limited to a relatively short-term horizon for analysis purposes. Thus, an interpretation of Section 1323(a) as applicable to power purchases from QFs would, in effect, prohibit rate levelization, a result clearly not intended by the Legislature in the enactment of Act 114 of 1986. Moreover, rates paid to QFs are governed by federal law, as opposed to state statutes governing retail electric rates. The test year concept is used in the traditional rate setting process by which a utility's base rates are determined, and has no applicability to costs paid pursuant to PURPA 210. As discussed above, rate levelization specifically is authorized by federal law. Therefore, we reject Armco/Allegheny's proposed interpretation of Section 1323(a)

as applicable to power purchase agreements between utilities and qualifying facilities.

Since we previously have found that the relief requested by West Penn is appropriate, we grant West Penn's request and find that the Monongahela, Burgettstown and Shannopin Mine capacity will not result in an excess capacity determination with respect to the capacity of the projects themselves or as to any existing West Penn capacity.

4. *West Penn's request to publish the Order for comment in the Pennsylvania Bulletin.*

Consistent with its prior practice, West Penn has requested that we issue a tentative opinion and order in these proceedings and publish it for comment in the Pennsylvania Bulletin. Our decision regarding this request is within our discretion, as there is no legal requirement or entitlement to have an order published for comment in the Pennsylvania Bulletin. We in fact rarely publish orders unless the order sets a new precedent on a legal issue of some interest to the public at large, which is not the case in the instant proceeding. No other utility in Pennsylvania requests the relief requested by West Penn. In the past, we have twice granted West Penn's request for publication (AES Beaver Valley and Allegheny Lock and Dam No. 6) and three times denied the request (Milesburg Energy, Allegheny Lock and Dam No. 5 and modification to Allegheny Lock and Dam No. 6).

In the instant proceedings, we will exercise our discretion by granting, in part, West Penn's request. Rather than publication of this lengthy order, we will direct publication of a notice that a tentative opinion and order in these proceedings has been adopted and is available upon request from West Penn. Absent the filing of any exceptions, the tentative opinion and order will become final within thirty (30) days of the publication of the notice.

Although we will exercise our discretion by granting West Penn's request, in part, in the instant proceeding, we caution West Penn that our decision does not guarantee relief of the type requested in future proceedings. Should West Penn in the future file a similar petition or petitions, West Penn is advised to contact the Commission's staff to discuss a method that would satisfy West Penn's concerns by providing the notice perceived necessary by West Penn at the time its initial pleading is filed.

5. *West Penn's Motion for a Protective Order.*

Upon review of the document under seal, we are of the opinion that the exhibit does not reveal anything of relevance to the proceeding under review. The exhibit is merely an APS internal memorandum with an attached computer printout containing certain information on all QF projects on the APS "active negotiations list . . . which are not the projects in the integrated resource plan." N.T. 1513. According to Armco/Allegheny, reference to this exhibit would demonstrate, *inter alia*, that price agreement between West Penn and North Branch was not reached in October 1986.

Our review of the computer printout reveals that the information set forth therein is not completely accurate. For example, the status of the contract with the Allegheny Lock and Dam Nos. 5 and 6 projects is not accurate as of the date of the printout. We have no reason to question West Penn's sworn statement that price agreement was reached in October 1986. Moreover, the date that controls evaluations of avoided costs is the time period during which active negotiations take place, as opposed to the time firm price agreement is reached. This provision is designed to protect QFs from the loss of entitlement to particular rates in the event that a utility "stonewalls" on acceptance of a price offer. Therefore, there is no need to have this exhibit admitted to the record in this proceeding.

With respect to West Penn's request that we strike Armco/Allegheny's Reply and require that all copies of the Reply be returned to the Commission for destruction, we agree with Armco/Allegheny that no specific factual information was revealed in the Reply. Therefore, we will deny West Penn's request for the above-stated relief, but note that the exhibit continues to be subject to the protective order issued by ALJ Klovekorn. Because the document does not contain any information of relevance in the instant proceeding, we will prohibit any future references to the document however carefully they may be worded.

Consistent with our prior orders in similar proceedings, we decline to review the non-price terms of the proposed agreements; THEREFORE,

IT IS ORDERED:

1. That the Petitions to Intervene filed by Airco Industrial Gases ("Airco"), Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny"), North Branch Energy Partners, L.P. ("North Branch"), and Mon Valley Energy Corporation ("Mon Valley") are granted.

2. That the rates established by the proposed power purchase agreements between West Penn Power Company ("West Penn") and the developers of the Monongahela, Burgettstown and Shannopin Mine Projects are approved as just, reasonable and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the power purchase agreements through the Energy Cost Rate, or such mechanism as may replace the Energy Cost Rate in the future.

4. That the capacity represented by the Monongahela, Burgettstown and Shannopin Mine Projects does not represent excess capacity as to the capacity itself, and does not result in excess capacity as to any existing West Penn capacity.

5. That West Penn's Motion for a Protective Order is denied to the extent consistent with the Order.

6. That a copy of this Tentative Opinion and Order be served upon West Penn, Airco, Armco/Allegheny, North Branch, Mon Valley and the Office of Consumer Advocate.

7. That the Law Bureau prepare a notice for publication in the *Pennsylvania Bulletin* stating that the Commission has adopted the tentative opinion and order of today's date; that copies of the tentative opinion and order may be obtained from West Penn; and that the tentative opinion and order shall become final absent the filing of exceptions thereto within thirty (30) days of the publication of the notice.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: July 8, 1988

ORDER ENTERED: July 8, 1988

## APPENDIX F

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 29, 1988

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Linda C. Taliaferro
Joseph Rhodes, Jr.
Frank Fischl,
dissenting in part

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Docket Nos. P-880283, P880284, P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

RE: MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

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ORDER

BY THE COMMISSION:

Before us are the above-captioned petitions by West Penn Power Company ("West Penn") requesting approval of amounts to be paid pursuant to power purchase agreements with the developers of the Monongahela Lock & Dam No. 8 Project ("Monongahela Project"), the Burgettstown Project, and the Shannopin Mine Project. By tentative Opinion and Order entered July 8, 1988 we

found, *inter alia*, that the rates established by the proposed power purchase agreements were just, reasonable, and in the public interest, and authorized West Penn to fully collect all costs paid pursuant to the power purchase agreements from ratepayers. Our Tentative Opinion and Order was published in the *Pennsylvania Bulletin* for Comment at 18 *Pa.B.* 3397 (July 30, 1988).

Timely Exceptions to our Tentative Opinion and Order have been received from Mr. F. Alan Sever, the West Penn Power Industrial Intervenors ("WPPII"),[1] the Office of Consumer Advocate ("OCA"), West Penn, and Armco, Inc. and Allegheny Ludlum Steel Corp. (collectively "Armco/Allegheny"). West Penn in turn filed Replies to the Excepitons of WPPII, OCA and Armco/Allegheny. Although our Tentative Opinion and Order by its own terms was to become final if no Exceptions were filed, the filing of the above-referenced Exceptions has prevented this from occurring. Consequently, West Penn's Petitions, the Tentative Opinion and Order and the Exceptions thereto are before us for further consideration.

## DISCUSSION

Subsequent to the issuance of our Tentative Opinion and Order, the Commonwealth Court of Pennsylvania ("Commonwealth Court") on August 22, 1988 issued an Opinion and Order in a proceeding involving three consolidated appeals from our Order at *Petition of West Penn Power Company Re Milesburg Energy, Inc.*, Docket No. P-870216 (September 22, 1987). That Order approved rate recovery of amounts proposed to be paid under a power purchase agreement between West Penn and Milesburg Energy, Inc. ("MEI"), and granted West Penn's request for protective language under Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323. The Common-

[1] In these proceedings, the WPPII group is comprised of Airco Industrial Gases, Latrobe Steel Co., PPG Industries, Inc. and Powder Metal Products, Inc.

wealth Court's Opinion and Order [2] vacated the Commission's Order of September 22, 1987 and remanded the matter to us to reconsider our declaration that the capacity credit proposed to be paid to MEI was in the public interest, and our declaration that we will not consider the capacity represented by the Milesburg Project in future West Penn excess capacity determinations. In particular, the Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of West Penn's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers must be afforded due process. Slip Opinion at 21-22. In an analysis of what process is due, the Court held that, since payments for capacity were involved, the Commission should require West Penn to provide notice to its customers "in a manner consistent with that prescribed in 52 Pa. Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices." Slip Opinion at 29. With regard to the opportunity to be heard, the Court held that "the [C]ommission must devise a procedure that provides the *essential elements of a hearing*, but allows for consideration of petitions of the type involved here *in as expeditious and minimally burdensome a manner as possible*." Slip Opinion at 27 (emphasis supplied).

Although the Commission filed a Petition for Reargument of the Commonwealth Court's decision on September 6, 1988, we find it advisable in the instant proceedings to adhere to the procedural requirements imposed upon us by the Commonwealth Court's Opinion and Order. Failure to do so could subject the Commission's final Order in these proceedings to additional challenges, which would needlessly delay finalization of the proceedings

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[2] *David M. Barasch et al. v. Pennsylvania Public Utility Commission*, Nos. 2418, 2499 and 2522 C.D. 1987 (filed August 22, 1988).

further. Accordingly, we will direct West Penn to notify its customers of the filing of the above-referenced petitions by bill insert, and will assign the proceedings to the Commission's Office of Administrative Law Judge ("OALJ") for hearing and recommended decision. The bill inserts should notify customers, at a minimum, of the general nature and docket numbers of the proceedings, the amount of the capacity credits on a per kwh basis, the general methodology by which the energy credits will be determined, the size in MW of the projects, the expected in-service dates of the projects, and the steps necessary to file a formal complaint with the Commission.

In so ordering, we have two observations. First, we note that the Commonwealth Court has *not* imposed upon the Commission a requirement that petitions of the type involved here be subjected to an exhaustive proceeding in the nature of a general rate increase proceeding under Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d). Accordingly, we will direct the OALJ to limit the scope of discovery, the admission of testimony and evidence; and the cross-examination of testimony to issues that are relevant to our consideration of West Penn's petitions. In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers. As we stated in our Tentative Opinion and Order, "the heart of the matter really is whether West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law." Tentative Opinion and Order at 22-23. An examination of this ultimate factual issue to be resolved will include an examination

of several sub-issues of fact, including but not limited to projections of West Penn's installed capacity and customer demand. With respect to the appropriate reserve margin for West Penn, our Tentative Opinion and Order relied upon the two prior litigated Bath County proceedings at Docket Nos. R-842632 and R-850220 where we found the optimum reserve margin for West Penn was 28 percent. West Penn's projected need for capacity in the instant proceedings was based on a *lower* planning reserve margin of 25%. OCA's Exceptions to the Tentative Opinion and Order argue, *inter alia*, that the doctrine of collateral estoppel should not be applied to our prior findings on West Penn's appropriate reserve margins. We will leave the issue of whether collateral estoppel is properly applicable to our prior findings to the ALJ for his/her consideration and recommendation.

To continue with our observations regarding the proper scope of the proceeding, we note that the Commission evaluates a utility's avoided costs as of the time negotiations between the utility and developer take placé. Although we recognize that projections of avoided costs may decline over time, the opposite phenomenon also may occur. In order to prevent avoided cost rates from evolving into a constantly moving target, and to prevent utilities from depriving qualifying facilities ("QFs") of avoided cost rate entitlement by delaying negotiations, we consistently have evaluated avoided costs by reference to the time period during which serious negotiations take place. The procedural requirements imposed upon us by the Commonwealth Court have not affected the methodology by which this Commission calculates avoided costs. Nevertheless, Armco/Allegheny's Exceptions to the Tentative Opinion and Order argue that, *as a matter of law*, the agreements must be evaluated with reference to West Penn's current avoided costs. We reject this argument. FERC's preamble to its regulations states, *inter alia*, that "[u]se of the term 'legally enforceable obligation' is in-

tended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility." *Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, Docket No. RM79-55, Order No. 69 (February 19, 1980) as published at 45 *Fed. Reg.* 12214, 12224 (February 25, 1980). FERC further stated that the import of its regulations "is to ensure that a qualifying facility which has obtained the certainty of an arrangement, is not deprived of the benefits of its commitment as a result of changed circumstances." *Id.* Therefore, we reject Armco/Allegheny's argument that, as a matter of law, the agreements under review must be evaluated against West Penn's current avoided costs. Nevertheless, Armco/Allegheny may wish to argue that, as a matter of policy, the Commission should change the time frame against which avoided costs are evaluated. We do not wish to foreclose arguments for or against changes in Commission policy, although we note that our policy has worked well by providing a uniform framework against which agreements are evaluated in a consistent manner. Therefore, we leave the issue of whether or not to consider arguments for a change in policy to the ALJ's discretion, with a cautionary note that any such policy change advocated by Armco/Allegheny or other parties would have major impact on this Commission's implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA 210"). Finally, we note that the Commonwealth Court affirmed the Commission's practice of approving agreements that provide for levelized payments, including the payment of capacity credits prior to the date that a utility projects a need for capacity. Slip Opinion at 33-38. Consequently, the ALJ should exclude this issue of timing and the "inter-generational" inequity argument from the scope of the proceeding to the extent that these arguments have been addressed and decided by the Commonwealth Court.

A second observation is that, as a practical matter, it would be preferable to consolidate the Milesburg proceeding at Docket No. P-870216 with the instant proceedings, and to consider all four proposed power purchase agreements together. The Milesburg, Burgettstown and Shannopin Mine Projects are based on the same generation plan, which projected a need for capacity in 1995. The common factual issues to these proceedings should be addressed together to minimize the expense to all of the parties involved, as well as to serve administrative economy. However, we do not, as of the date of this Order, have jurisdiction over the Milesburg proceeding. Rule 2572(a)(2) of the Pennsylvania Rules of Appellate Procedure provides that an application for reargument or a petition for allowance of appeal from the order "shall stay the remand of the record until the disposition thereof, and until 30 days after the entry of a final order in the appellate court possessed of the record." Pa.R.A.P. 2572(a)(2). In accordance with this provision, the earliest that we will regain jurisdiction over the Milesburg proceeding is thirty (30) days after our Petition for Reargument is acted upon by the Commonwealth Court. If the Commonwealth Court addresses the Petition for Reargument within a relatively short period of time, *and* no party (including the Commission) files a Petition for Allowance of Appeal with the Pennsylvania Supreme Court, the scheduling of the above-captioned proceedings may be able to accommodate consideration of West Penn's petition governing the Milesburg Project as well. Of course, we can not predict whether any party will Petition the Supreme Court for Allowance of Appeal, and in fact have not resolved this question on our own behalf. Nevertheless, we will request West Penn to include notice of the filing of the Milesburg petition in the bill insert required by the instant order so that we can consolidate all four proceedings if future events make that disposition possible.

As a final matter, we note that the Commonwealth Court's Opinion states that the Commission "should make

its own calculations of the maximum allowable capacity cost credit part of the record of the [Milesburg] proceeding, and it should provide access to its calculations to interested parties before the hearing." Slip Opinion at 27. In order to implement this directive in the instant proceedings, we will direct our advisory staff to calculate an estimated capacity credit to which the various developers would have been entitled under our regulations in the absence of a negotiated agreement, and to supply the calculaions to the ALJ and to the parties prior to the commencement of evidentiary hearings. Of course, these calculations will not be conclusive as to any issues to be decided in these proceedings, but will represent merely an application of the capacity credit formula set forth in our regulations at 52 Pa. Code § 57.34(c) to data on file at the Commission; THEREFORE,

IT IS ORDERED:

1. That West Penn Power Company ("West Penn") notify its customers of the filings of the above-captioned petitions by bill insert, to include at a minimum the information set forth above.

2. That the proceedings are consolidated for the purpose of hearing and assigned to the Office of Administrative Law Judge.

3. That a copy of this Order be served upon West Penn, the Office Consumer Advocate, Armco, Inc. and Allegheny Ludlum Steel Corp., the West Penn Power Industrial Intervenors, and Mr. F. Alan Sever.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 29, 1988
ORDER ENTERED: September 30, 1988

**APPENDIX G**

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held January 19, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl

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Docket Nos. P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

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OPINION AND ORDER ON RECONSIDERATION

BY THE COMMISSION:

INTRODUCTION

On September 30, 1988, we entered an Order at Docket Nos. P-880283, P-880284, and P-880286 that, *inter alia*, consolidated those proceedings for the purpose of

hearing and assigned them to the Office of Administrative Law Judge ("OALJ"). On October 27, 1988, we entered an Order at these docket numbers that granted, pending further consideration of the merits, the variously-styled Petitions for Reconsideration that were filed by the West Penn Power Industrial Intervenors ("WPPII"), Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny"), North Branch Energy Partners ("North Branch"), and West Penn Power Company ("West Penn").

Our order of today's date addresses the various Petitions for Reconsideration on the merits. In addition, it formally consolidates the proceeding at Docket P-870216, which pertains to Milesburg Energy, Inc., with the other three proceedings that we previously consolidated for the purpose of hearing.

## BACKGROUND

Our September 30, 1988 Order was issued in response to *Barasch v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, 546 A.2d 1296 (1988) ("*Milesburg*"). As we noted, the Commonwealth Court in that appeal vacated our order at Docket No. P-870216 of September 22, 1987 granting West Penn's Petition for rate recovery approval of amounts proposed to be paid to Milesburg Energy, Inc. ("MEI") and remanded the proceeding to the Commission. The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of West Penn's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers be given notice of the filing of the petition and that "the [C]ommission must devise a procedure that provides the essential elements of a hearing, but allows for consideration of petitions of the type involved here in as

expeditious and minimally burdensome a manner as possible." 546 A.2d at 1307.

Pursuant to our September 30, 1988 Order, West Penn has provided notice of the filing of all four above-captioned petitions, including the petition governing its proposed power purchase agreement with MEI, by bill insert. Although we may not have had jurisdiction over the Milesburg proceeding on September 30, 1988 due to our Petition for Reargument of September 6, 1988 that was then pending before the Commonwealth Court, West Penn included notice of the MEI petition in its bill inserts pursuant to our request and in order to facilitate future consolidation of the MEI petition with the other three proceedings. Consequently, notice of the filing of all four petitions has been perfected.

On November 3, 1988, the Commonwealth Court filed an opinion and order in *Milesburg* granting in part and denying in part the Commission's Petition for Reargument. Relevant to the instant proceedings, the Commonwealth Court held that its August 22, 1988 decision "shall not have retroactive effect, but shall be applicable only to the petition for approval of the proposed contract in this case, between West Penn Power Company and Milesburg Energy, Inc., and to petitions filed with the PUC after August 22, 1988." Although West Penn's petitions governing Monongahela Lock and Dam No. 8 and the Burgettstown and Shannopin Mine Projects were filed *before* August 22, 1988, we will voluntarily apply the *Milesburg* requirements to these proceedings as contemplated by our September 30, 1988 Order. Our Petition for Reargument had requested only that prior Commission decisions approving rate recovery under PURPA 210 be, in essence, grandfathered under *Milesburg*.

On December 5, 1988, we filed a Petition for Allowance of Appeal of *Milesburg* with the Pennsylvania Supreme Court. The only aspect of *Milesburg* for which

we have sought review is the Commonwealth Court's prescription of the form of notice that the Commission must provide of rate recovery petitions similar to the one governing the proposed power purchase agreement between West Penn and MEI. Under the Pennsylvania Rules of Appellate Procedure, our Petition for Allowance of Appeal of this limited aspect of the Commonwealth Court's Opinion and Order does not prevent us from proceeding with the West Penn petition governing the proposed power purchase agreement with MEI. Pa. R.A.P. 1701(c). No other Petition for Allowance of Appeal of *Milesburg* having been filed,[1] our Order of today's date will formally consolidate all four docket numbers for the purpose of hearing.

## DISCUSSION

The four variously-styled Petitions for Reconsideration will be discussed separately as set forth below.

West Penn filed a Petition for Reconsideration of our September 30, 1988 Order and a Request for Extraordinary Relief on October 17, 1988.[2] West Penn avers that it must have the proceeding concluded as quickly as possible in order to properly and orderly plan its generating capacity to serve the future needs of its ratepayers, and notes that the "litigation in these matters and in

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[1] MEI filed a Cross-Petition for Allowance of Appeal on December, 19, 1988 which subsequently has been withdrawn.

[2] MEI filed an Answer supporting West Penn's Petition and Request on October 27, 1988. MEI avers that prompt resolution of the proceedings is critical to it due to the Financial Closing Date of February 28, 1989 for its project. OCA, WPPII and Armco/Allegheny jointly filed an Answer opposing West Penn's Request for Extraordinary Relief on October 26, 1988, generally opposing the procedural schedule proposed by West Penn. OCA also on October 26, 1988 filed a Response supporting West Penn's and related Petitions for Reconsideration to the extent the Petitions seek clarification that the September 30 Order does not contain any final determinations of contested issues.

the Milesburg case collectively involve more than 200 MW of generating capacity . . . and creates uncertainty as to whether West Penn will be able to rely on these projects to meet its future generation needs." Petition, p. 4. In order to expedite the hearing process, West Penn requests that the Commission itself, rather than the OALJ, preside over the hearings. This procedure would, according to West Penn, avoid the procedural delay occasioned by the time allowed for the filing of exceptions to the ALJ's recommended decision and the time necessary for the Commission to study the record in order to rule on the exceptions.

Although we are cognizant of the need to conclude these proceedings as quickly as possible, we will deny this request. It would not be practical to attempt to schedule evidentiary hearings before four Commissioners, all of whom have competing demands for their time and attention. Nevertheless, we will direct the OALJ to expedite the proceeding in any manner that is possible. Our September 30, 1988 Order implicitly conveyed as much by citing to the Commonwealth Court's directive to provide the "essential elements of a hearing" in a proceeding allowing for "consideration of the type involved here *in as expeditious and minimally burdensome a manner as possible*." 546 A.2d at 1307 (emphasis supplied). Although we will not establish a firm deadline for the issuance of a recommended decision by the OALJ due to our inability to foresee all contingencies, we would request that a recommended decision be issued within two to three weeks after main briefs are filed, and suggest that the filing of reply briefs be eliminated. If hearings can be concluded by the end of February, this would permit the issuance of the recommended decision by the end of March.

West Penn also requests that the Commission provide for a trial type proceeding rather than a rate case type proceeding. By a trial type proceeding, West Penn means

a procedure whereby a mutual discovery period is followed by a continuous hearing at which all witnesses and all cross-examination are presented on a continuous basis. West Penn states that, in order to facilitate such a proceeding, liberal discovery should be allowed but a cutoff should be required before the hearings.

As we have decided that these proceedings should remain assigned to the OALJ, we shall refer consideration of this request to the ALJ assigned to the proceeding.

Finally, West Penn requests that the Commission indicate that the September 30, 1988 Order is not a final and appealable order, and that the final and appealable Order will not be rendered until the proceedings are concluded at the Commission. West Penn notes that granting this request would avoid the delay that could occur if the September 30 Order were appealed to the Commonwealth Court. West Penn suggests that the Commission order that all parties shall retain their rights to appeal any aspect of the September 30 Order until the conclusion of the appeal period following the entry, after hearing, of a final order on the merits. North Branch, the developer of the Burgettstown Project, similarly requests in its Motion for Reconsideration of October 17, 1988 that the Commission add an ordering paragraph to its September 30 Order stating that the Order is interlocutory in order to eliminate any appeals until the entry of a final order.

We will grant the requests of West Penn and North Branch and explicitly state what already is implicit, e.g., that the September 30 Order, as well as today's Order, are interlocutory only, and that all parties will have the opportunity to appeal any issue decided by the interlocutory orders at the conclusion of these proceedings.

WPPII filed a Petition for Reconsideration of the September 30 Order on October 14, 1988. WPPII objects to our directive to the OALJ to exclude the issue of the

appropriateness of levelization of rates paid to qualifying facilities from the scope of the proceeding. WPPII avers that, although the Commonwealth Court determined that levelized payments are consistent with Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA"), the Court did not rule on the issue of whether the portion of the levelized payment which exceeds current avoided costs is recoverable from ratepayers on a current basis. WPPII requests that it be permitted to introduce testimony regarding a deferral mechanism that would delay recovery by West Penn of amounts paid to the qualifying facilities that exceed West Penn's current avoided costs.

WPPII's position on this issue has been considered and rejected by this Commission on *numerous* occasions, beginning with *AES Beaver Valley v. West Penn Power Co.*, Docket No. C-844022 (March 13, 1985). In fact, the Lehigh Valley Power Committee ("LVPC"), which is represented by the same law firm as WPPII, in the last several months has appealed two Commission Orders to the Commonwealth Court on this identical issue. The first appeal, at No. 1002 C.D. 1988, was argued before the Commonwealth Court on November 2, 1988. The second appeal, at No. 1620 C.D. 1988 was subject of a Commission brief filed with the Commonwealth Court on November 21, 1988. As we have noted over and over again, federal law expressly sanctions levelization of rates paid to qualifying facilities, our regulations require the payment of levelized rates, and there is nothing under federal law which defines or permits a concept of "ratepayers' avoided costs" separate from a utility's avoided costs. To the contrary, Congress and the Federal Energy Regulatory Commission ("FERC") have defined "full avoided costs", including levelized costs, as those which *are* just and reasonable to electric consumers. 16 U.S.C. § 824a-3(b) and (d); *American Paper Institute v. American Electric Power Service Corporation,* 461 U.S. 402

(1983). WPII's request essentially is a collateral attack upon the framework of FERC's regulations implementing PURPA, our own regulations implementing PURPA 210, and the numerous Commission Orders that have considered and rejected this issue in the past. An appropriate proceeding available to WPPII to raise this issue on a generic basis is the *Investigation upon the Commission's Own Motion Into the Regulations at 52 Pa. Code § 57.31 et seq.*, Docket No. I-860025, which was designed to review our PURPA 210 regulations and make any necessary or appropriate changes to them on a prospective basis. Absent any change to our regulations, rate levelization and rate recovery of levelized payments are required in Pennsylvania. Granting WPPII's petition for reconsideration on this issue therefore would serve no useful purpose, and simply would waste the parties' and our own time and resources, and needlessly delay the proceedings that of necessity must be concluded in as expeditious a manner as possible. Of course, our explicit recognition of the interlocutory nature of this and our September 30 Order preserves WPPII's right to appeal this issue at the conclusion of the proceeding. The issue of the levelization of payments to qualifying facilities and the rate recovery thereof being so fundamentally a cornerstone of our implementation of PURPA, we perceive no danger in excluding this issue from the scope of the proceeding prior to hearing.

The final pleading to be addressed is Armco/Allegheny's Petition for Reconsideration of October 17, 1988.[3]

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[3] West Penn filed a Reply to Armco/Allegheny's Petition on October 31, 1988. West Penn requests that the Petition be denied except to the extent it requests that the September 30 Order be deemed interlocutory and to the extent that in West Penn's view the fundamental issue to be resolved is whether the proposed rates are at or below West Penn's avoided costs as calculated by West Penn's methodology, as opposed to the methodology set forth in the Commission's regulations.

Armco/Allegheny request that we reconsider certain aspects of our September 30 Order or, in the alternative, modify the Order to state that no final determination has been made regarding these aspects of our Order. Armco/Allegheny's alternative request, which is granted as set forth above, was made to prevent the necessity of filing an interlocutory appeal prior to the conclusion of the proceeding. Armco/Allegheny's other arguments focus on the statement in our September 30 Order at page 3 that "the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers." Armco/Allegheny's objection to this language is based on Section 527 of the Public Utility Code, 66 Pa. C.S. § 527, which states, *inter alia*, that "[T]he Commission shall require that utility rates to the public reflect savings to the utility from cogeneration." Armco/Allegheny have cited this statutory language as support for the somewhat novel proposition that our regulations implementing PURPA 210 cannot be used as the benchmark for determining the reasonableness of rates paid to qualifying facilities. This argument requires little attention. Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's *full* avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. As we are unaware of any support for Armco/Allegheny's assertion that the General Assembly intended to exempt Pennsylvania from the full avoided cost rule, we reject this argument. Statutes may be interpreted by presuming that the General Assembly did not intend to violate the Constitution of the United States. 1 Pa. C.S. § 1922(3).

Armco/Allegheny's second point on which it seeks reconsideration concerns our observation in our September 30 Order that we consistently have evaluated avoided costs as of the time negotiations between the utility and the developer occur, and our holding rejecting Armco/Allegheny's argument that, as a matter of law, the agreements must be evaluated with reference to West Penn's current avoided costs. But for the Section 527 argument, *supra*, Armco/Allegheny have not raised anything not previously considered on this point. Therefore, we deny their petition for reconsideration on this point, while noting that under the terms of the September 30 Order, parties are free to argue that circumstances unique to these proceedings justify a departure from this policy in this case.

Having addressed the various pleadings filed in response to our order of September 30, 1988; THEREFORE,

IT IS ORDERED:

1. That the proceeding at Docket No. P-870216 pertaining to the proposed power purchase agreement between West Penn Power Company and Milesburg, Inc. is consolidated with the proceedings at Docket Nos. P-880283, P-880284 and P-880286 for the purpose of hearing.

2. That the Order of September 30, 1988 and the Order of today's date are interlocutory, and all holdings set forth in these Orders will be subject to review by the filing of a Petition for Review upon the entry of a final Commission Order in these proceedings.

3. That the balance of the variously-styled Petitions for Reconsideration are granted or denied consistent with the foregoing opinion.

4. That a copy of this Opinion and Order be served upon all parties to above-captioned proceedings.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: January 19, 1989
ORDER ENTERED: January 19, 1989

## APPENDIX H

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Docket Nos. P-870216
P-880283
P-880284
P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

RE: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

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RECOMMENDED DECISION

Before
Larry Gesoff
Administrative Law Judge

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## I. HISTORY OF THE PROCEEDINGS

On April 2, 1987 West Penn Power Company (WPP) filed a Petition for approval of an Electric Energy Purchase Agreement (EEPA) between it and Milesburg Energy, Inc. (MEI) and for advance approval for recovery through its energy cost rate (ECR) of all energy and capacity costs incurred under the EEPA. The Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) filed answers to the Petition and Armco, Inc. and Allegheny Ludlum Corporation (AAL) jointly filed a Petition to Intervene and a Motion to Dismiss the WPP Petition. MEI intervened in support of the WPP Petition and filed responses to the pleadings of OTS, OCA and AAL.

On September 22, 1987, the Commission, without a hearing, entered an order accepting the WPP/MEI EEPA for filing under 52 Pa. Code § 57.32(c)(2)[1], determining that the EEPA was in the public interest, authorizing ECR recovery of expenses paid by WPP to MEI under the EEPA, and declaring that it will not consider additional generation capacity resulting from the EEPA in determining the reserve margins or economic benefits resulting from any base load or other generating unit during the term of the contract.

On October 9, 1987 WPP filed a petition for reconsideration of the Commission's Order entered September 22, 1987, requesting that the Commission publish its Order in the *Pennsylvania Bulletin* so that WPP's ratepayers would receive notice of the pass through to them of the capacity and energy charges incurred by WPP during the

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[1] 52 Pa. Code §§ 57.31-57.39 contain the Commission's regulations governing the purchase and sale of energy and capacity between electric utilities and qualifying facilities (QF's) pursuant to Section 210 of the Public Utility Regulatory Policies Act (PURPA) 16 U.S.C. § 824a-3(a)-(j), and regulations promulgated thereunder at 18 C.F.R. §§ 292.101 *et seq.*

30 year duration of the EEPA.[2] On or about October 6, 1987, OCA petitioned the Commission to clarify and reconsider its Order entered September 22, 1987, specifically requesting that the Commission 1) clarify that its approval of the WPP/MEI EEPA has no impact on the base rate proceedings at Docket No. R-850220 (in which, at the time, excess capacity was being addressed on reconsideration on WPP's sought recovery of costs related to the Bath County pumped storage project (Bath County)), 2) clarify that the Order makes no findings regarding WPP's then present capacity situation, and 3) not apply its proposed policy statement on Section 1323 of the Public Utility Code (Code), 66 Pa. C.S. § 1323.[3] On or about October 6, 1987, AAL filed a Petition for reconsideration of the September 22, 1987 Order contending, among other things, that it was entered without a due process mandated hearing. WPP replied to the petitions of OCA and AAL.

By a vote of two to two at a public meeting held October 22, 1987, the Commission declined to grant reconsideration. WPP, OCA and AAL appealed separately from the Commission's September 22, 1987 Order and the Pennsylvania Commonwealth Court (Commonwealth

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[2] In its original Petition, WPP requested that the Commission issue a declaratory order and publish it for public comment in the *Pennsylvania Bulletin*, but the Commission's Order did not so provide.

[3] Section 1323 provides for certain disallowances if the Commission finds that a utility has excess capacity as the result of claiming costs, for the first time, of an electric generating unit in its rates. Section 1323(c) creates an exception for certain cogeneration projects affecting the excess capacity analysis of certain baseload plants. The Commission's proposed policy statement regarding the treatment of purchases of capacity from QF's in excess capacity determinations was published for comment in the *Pennsylvania Bulletin* of July 18, 1987. Comments have been filed (at Docket No. L-870030), but as of this writing no action has been taken.

Court) consolidated the appeals. *Barasch, et al. v. Pennsylvania Public Utility Commission*, Nos. 2418, 2499 and 2522, C.D. 1987.

On December 31, 1987, January 5, 1988 and January 20, 1988, WPP filed petitions requesting approval of rate recovery of amounts paid pursuant to EEPAs with the developers of the Monongahela Lock and Dam No. 8 Project (Monongahela Project), the Burgettstown Project and the Shannopin Mine Project, respectively. In its petitions, as in the MEI petition, WPP requested ECR pass through, public notice and a comment period, and a finding of no excess capacity under Section 1323. OCA filed answers to all three petitions; Airco Industrial Gases filed petitions to intervene in all three petitions, but filed no answers; and AAL filed petitions to intervene in all three petitions, but filed answers only to the Burgettstown and Shannopin Mine Project. North Branch Energy Partners, L.P. (North Branch), the developer of the Burgettstown Project filed a petition to intervene in the proceeding at P-880284 and a statement in support of WPP's petition. Mon Valley Energy Corporation (Mon Valley), developer of the Shannopin Mine Project filed a petition to intervene in the proceeding at P-880286. WPP filed replies to the answers of OCA and AAL. North Branch filed responses to the answers of AAL and OCA to WPP's Burgettstown Project petitions. Mon Valley filed responses to the answers of AAL and OCA to the Shannopin Mine Project petitions. AAL filed a reply to the response of North Branch to AAL's answer to the Burgettstown Project petition.

The Commission, without a hearing, by Tentative Opinion and Order entered July 8, 1988, among other things, 1) granted all petitions to intervene, 2) approved the rates in all three EEPAs as just, reasonable and in the public interest, 3) authorized ECR recovery of all costs paid under the EEPAs, 4) declared that the capacity represented by the projects does not represent excess capacity

as to the capacity itself or as to any existing WPP capacity, 5) provided for publication of notice of the Tentative Opinion and Order in the *Pennsylvania Bulletin*, and 6) provided that the Tentative Opinion and Order would become final absent the filing of exceptions within 30 days of publication of the notice. Timely exceptions were filed by Mr. F. Alan Sever, the West Penn Power Industrial Intervenors (WPPII),[4] OCA, WPP, and AAL. WPP filed replies to the exceptions of WPPII, OCA and AAL.

After the Commission entered its Tentative Opinion and Order, Commonwealth Court on August 22, 1988, vacated the Commission's Order of September 22, 1987 (approving the WPP/MEI EEPA at Docket No. P-870216) and remanded the proceeding for Commission reconsideration of its declaration that the capacity credit proposed to be paid to MEI was in the public interest, and its declaration that it will not consider the capacity represented by the Milesburg Project in future West Penn excess capacity determinations. *Barasch, et al. v. Pennsylvania Public Utility Commission*, 119 Pa. Commw. 81, 546 A.2d 1296 (1988) (*Milesburg*). The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of WPP's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers must be afforded due process. *Milesburg* at 1305. Accordingly, the Court held that, since payments for capacity were involved, the Commission should require West Penn to provide notice to its customers "in a manner consistent with that prescribed in 52 Pa. Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices." *Milesburg* at 1308. With regard to the opportunity to be heard, the Court held that "the [C]ommission

[4] In these proceedings, the WPPII group is comprised of Airco Industrial Gases, Latrobe Steel Co., PPG Industries, Inc. and Powder Metal Products, Inc.

must devise a procedure that provides the *essential elements of a hearing*, but allows for consideration of petitions of the type involved here *in as expeditious and minimally burdensome a manner as possible.*" *Milesburg* at 1307. (emphasis supplied)

In response to *Milesburg*, by Order entered September 30, 1988, the Commission consolidated the Monongahela, Burgettstown and Shannopin petitions and assigned them to the Office of Administrative Law Judge for hearing and recommended decision. WPP was directed to notify its customers of the three petitions by bill insert.

In the body of its Order, the Commission included two observations regarding the proper scope of the hearing. These are noted in some detail here because they provide a preliminary statement of some of the issues in these proceedings. The following contains part of the Commission's first observation:

> The Commonwealth Court has *not* imposed upon the Commission a requirement that petitions of the type involved here be subjected to an exhaustive proceeding in the nature of a general rate increase proceeding under Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d). Accordingly, we will direct the OALJ to limit the scope of discovery, the admission of testimony and evidence; and the cross-examination of testimony to issues that are relevant to our consideration of West Penn's petitions. In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et. seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers. As we stated in our Tentative Opinion and Order, "the heart of the matter really is whether

> West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law." Tentative Opinion and Order at 22-23. An examination of this ultimate factual issue to be resolved will include an examination of several sub-issues of fact, including but not limited to projections of West Penn's installed capacity and customer demand. With respect to the appropriate reserve margin for West Penn, our Tentative Opinion and Order relied upon the two prior litigated Bath County proceedings at Docket Nos. R-842632 and R-850220 where we found the optimum reserve margin for West Penn was 28 percent. West Penn's projected need for capacity in the instant proceedings was based on a *lower* planning reserve margin of 25%. OCA's Exceptions to the Tentative Opinion and Order argue, *inter alia*, that the doctrine of collateral estoppel should not be applied to our prior findings on West Penn's appropriate reserve margins. We will leave the issue of whether collateral estoppel is properly applicable to our prior findings to the ALJ for his/her consideration and recommendation. (Mimeo at 3-4).

The Commission also rejects AAL's contention that as a matter of law the EEPAs must be evaluated with reference to WPP's current avoided costs as opposed to the time during which serious negotiations take place, which is the Commission's policy. The Commission, however, "leave[s] the issue of whether or not to consider arguments for a change in policy to the ALJ's discretion." Mimeo at 5. Finally, in its first observation, the Commission, noting that Commonwealth Court affirmed the Commission's policy of approving of levelized payments in agreements (including capacity payments before the date a utility projects a need for capacity), directs the ALJ to exclude the

issue of timing and of "inter-generational" inequity from the scope of the proceeding.

The Commission's second observation addresses the desirability to consolidate the Milesburg petition with the other three petitions. This was not possible at the time because the remand of the Milesburg record was stayed by applications for re-argument of the appeal. The Commission directed WPP to include the filing of the Milesburg petition in the same bill insert to facilitate future consolidation of all four proceedings. Finally, the Commission directed its advisory staff to calculate an estimated capacity credit to which the various developers would have been entitled under the Commission's regulations and to supply the calculations to the ALJ and the parties before the start of evidentiary hearings.

By Order entered October 27, 1988, the Commission responded to variously styled petitions for reconsideration of its September 30, 1988 Order filed by WPPII, AAL, North Branch and WPP. The Order grants reconsideration pending further consideration of the merits of the pleadings.

On January 19, 1989 the Commission entered its Opinion and Order on Reconsideration. In it the Commission notes that on November 3, 1988 the Commonwealth Court filed its opinion and order in *Milesburg*, among other things, holding that the Court's August 22, 1988 decision shall not be retroactive and shall apply only to the Milesburg petition and to petitions filed after August 22, 1988. Even so, the Commission voluntarily applied *Milesburg* to the Monongahela, Burgettstown and Shannopin petitions and consolidated all four proceedings for hearing and recommended decision. The Commission also directed that its Order of September 30, 1988 and the Order under discussion here (entered January 19, 1989) are interlocutory and that all holdings therein are subject to appellate review following entry of the Commission's final order. The Commission left to the assigned ALJ the

decision whether to grant WPP's request for a trial type hearing. While it did not set a firm deadline for the issuance of a Recommended Decision, the Commission requested that it be issued within two to three weeks after main briefs are filed, and suggested that the filing of reply briefs be eliminated.[5]

Also in the January 19, 1989 order, the Commission again rejects AAL's position on levelized rates and the time frame for determining avoided costs. In a slight change from its September 30, 1988 Order, the Commission stated that the "parties are free to argue that *circumstances unique to these proceedings* justify a departure from this [the Commission's time frame] policy in this case." Mimeo at 7. Also the Commission rejects AAL's argument under Section 527 of the Public Utility Code, 66 Pa. C.S. § 527. AAL asserts that because Section 527 directs the Commission to require that utility rates reflect savings to the utility from cogeneration, the Commission is prohibited from using its regulations as a benchmark for determining the reasonableness of rates paid to QF's. Mimeo at 6.

On August 4, 1988, while the *Milesburg* decision was pending, MEI filed a petition requesting 1) that a Commission investigation be opened, 2) that its EEPA with WPP be modified, and 3) that until further Commission Order, WPP be prohibited from constructing any generating unit whose construction would have been deferred by electricity purchases under the MEI/WPP EEPA. The contract modification sought is a two-fold reformation. First, MEI would be relieved of the September 1, 1988 deadline to obtain financing and all subsequent deadlines in the EEPA. Second, the contract would be reformed to require MEI to obtain financing under the EEPA not later than ninety days after a Commission order giving ad-

[5] As will be seen, the unforseen contingencies referenced in the Commission's order made it impossible to meet the Commission's requested schedule.

vance approval for recovery of all energy and capacity costs incurred becomes final and non-appealable. All other subsequent deadlines in the EEPA would be adjusted accordingly. This reformation was requested because Section 10.2 of the EEPA provided that if MEI did not obtain financing by September 1, 1988, the EEPA would terminate automatically. OTS, AAL, WPP, and OCA filed various styled responsive pleadings to MEI's Petition and MEI replied jointly to all four responses.

Reformation of a contract under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508 does not become effective until 30 days of service of the Commission's reformation order, which itself must be preceded by notice and hearing. Because MEI's reformation petition was filed less than 30 days before the financing deadline, Section 508 was not available. For this reason, by Consent Order dated August 31, 1988, adopted by the Commission on September 1, 1988, the parties agreed to extend the financing closing date to February 28, 1988 and extend other dates accordingly. The automatic termination clause of Section 10.2 was maintained, subject to extension by further order of the Commission. The consent order also provided that "MEI shall not seek nor be entitled to any capacity credit higher than that specified in the agreement executed on or about February 25, 1987." AAL Ex. 80.

On January 10, 1989, WPP submitted to the Commission an affidavit verifying that the bill inserts referenced in the Commission's Order of September 30, 1988 had been served upon its customers beginning on October 21, 1988. The Affidavit also verifies that notices containing the same language were posted in WPP offices and collection agencies and appeared in newspaper advertisements and news releases.

On February 10, 1989, MEI filed another petition to modify its EEPA with WPP 1) to recalculate the capacity costs to reflect a later on-line date of the project and 2)

to extend the financing closing date and other milestone dates. (MEI's Second Petition for Modification) By Order dated February 21, 1989, without waiting for responses and without holding a Section 508 reformation hearing, I granted the relief requested because the financing closing date was due to elapse on February 28, 1989. By order dated February 27, 1989, I rescinded my order of February 21, 1989.

At the prehearing conference held on February 27, 1989 I gave the reasons for my rescission order. In brief, my February 21, 1989 order was in error because there was no hearing and because even if a Commission order reforming the contract was entered on the day the petition was filed, it would not become effective under Section 508 until *after* the financing deadline elapsed.

On March 3, 1989, MEI filed a Petition for Emergency Order or Appeal of Judge Gesoff's February 27, 1989 order. By Order entered March 31, 1989, the Commission denied the request for an emergency order but required all parties to maintain the status quo pending consideration of MEI's Second Petition for Modification. MEI also filed exceptions to my February 27, 1989 order.

On March 15, 1989 WPP filed a Petition for leave to withdraw its Petition for approval of the MEI EEPA (WPP's Withdrawal Petition) on the grounds that the issues in the proceeding have been rendered moot as the EEPA terminated automatically by its own terms. MEI filed an answer to WPP's Withdrawal Petition; WPPII filed a statement in support of the petition; and MEI filed a response to WPPII's statement.

On March 22, 1989, AAL filed a Motion to dismiss WPP's MEI EEPA petition on the grounds that WPP's EEPA with MEI no longer exists. MEI responded with a pleading, styled as a preliminary motion and answer, requesting that AAL's motion to dismiss be denied. WPP filed an answer to MEI's Motion.

On April 3, 1989, North Branch filed a petition requesting modification of its EEPA with WPP (the Burgettstown Project) to change the Financing Closing Date, currently October 1, 1989, to be six months from the date of the Commission's final order; to extend the Commencement Date and adjust all other dates accordingly; and to modify the capacity credit to reflect the modified project in service date. AAL, OCA and WPP filed answers to the petition.

MEI's Second Petition for Modification, WPP's Withdrawal Petition, AAL's Motion to Dismiss, and North Branch's Petition were litigated during Phase Two of these proceedings. Phase One consists of the hearing on the merits of WPP's petitions for approval of the four EEPAs.

As noted, the prehearing conference in this proceeding occurred on February 27, 1985. During the prehearing conference, I granted the motions of OCA, AAL, WPPII and North Branch to compel answers to interrogatories. This necessitated a ruling that the Commission's approval of WPP's reserve margin in two previous base rate proceedings concerning Bath County (R-850220 and R-842632) would not preclude reserve margin as an issue in this proceeding. See pages 19 and 20 of the transcript of the prehearing conference. Also, requests for depositions were granted, the request of the developer of the Monongahela Project to sever its petition (P-880283) was denied, and a schedule for the submission of pre-filed direct testimony, for the hearing and for briefs as set.

A trial type hearing was held. Eight days of hearing, from April 3 to April 12, 1989, produced 1475 pages of transcript. Twenty different witnesses testified, and 28 Statements and 162 Exhibits were admitted into the record. The parties litigating this proceeding—WPP, MEI, North Branch, Mon Valley, AAL, WPPII and OCA (neither OTS nor the Monongahela Project developer partici-

pated)—filed Main Briefs on May 16, 1989 and Reply Briefs on May 31, 1989.[6]

On May 12, 1989, MEI filed a Petition to Modify its petition to modify its EEPA. WPP and ALL filed answers.

The reader is directed to the tables appearing at the end of WPP's Main Brief. The tables list each witness and the statements and exhibits they sponsored. This is necessary since exhibits premarked by the parties with a witness's initials were changed so that each party's exhibits are numbered sequentially; the text of the statements referring to the exhibits was not changed, however, and the table is provided to help the reader locate the correct exhibit.

As can be determined by this history and by what follows, it was not possible for these proceedings to provide "the essential elements of a hearing" while allowing for Commission consideration "in as expeditious and minimally burdensome a manner as possible." *Milesburg* at 1307. Nor was it possible to adhere to the Commission's suggested timetable. It is hoped, however, that the Commission can devise a speedier, less burdensome proceeding for future utility/QF petitions while still preserving due process rights for all parties. This is necessary, in my opinion, to prevent Pennsylvania from being a hostile environment for future QF projects. The nature of these proceedings, therefore, should not be viewed by potential QF's, QF developers and other interested entities as a model for future proceedings.

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[6] MEI, North Branch and Mon Valley submitted joint briefs which address common and individual interests. The Projects sponsored some witnesses and exhibits separately and some jointly. The joint briefs shall be referred to as BM&S Main Brief and BM&S Reply Brief. At times the three projects are referred to jointly as the Projects and sometimes individually, e.g., the Shannopin Project. Also the projects are sometimes referred to by project name and sometimes by developer name.

## II. THE PROJECTS AND THE EEPAs

### A. *The Milesburg Project*

This project is being developed and, if approved, will be operated by MEI which is owned by the Environmental Power Corporation. MEI St. 1 at 1.

The project will have a circulating fluidized bed boiler facility designed to burn bituminous coal refuse, to be located at the retired Milesburg Power Station in Milesburg, Centre County, Pennsylvania, previously operated by WPP and now owned by MEI. As a condition precedent to WPP's obligation to purchase capacity or energy from MEI, MEI must receive an Order from the Federal Energy Regulatory Commission (FERC), certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

The Project is expected to generate energy at an average rate in the range of 36.5 to 43 megawatthours per hour. The maximum installed capacity of the Project will be 43 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located with WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system.

MEI and WPP executed an EEPA dated February 25, 1987, concerning the terms and conditions on which MEI will sell and West Penn will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 11. In general, the EEPA provides for the sale by MEI and the purchase by WPP of all energy and capacity produced by the Project for a term commencing on or after January 1, 1990, and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the Agreement). The purchase price for such power consists of an energy component and, after the Project's Commencement Date, a capacity component.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on West Penn's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.3¢/Kwh. According to WPP, this capacity cost is essentially equal to its estimate of its levelized present value of avoided capacity over the life of the Project as of May 27, 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 attached to WPP's Petition for Approval of the EEPA.

WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of the Allegheny Power System (APS), of which WPP is a member company.

The capacity costs to be paid to MEI are levelized over the Project term. This levelization of capacity costs provides MEI with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to MEI is designed to equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA. As a further condition precedent to WPP's obligation to purchase capacity or energy from the Project, MEI must execute an agreement to purchase the Milesburg Power Station pursuant to stated terms and conditions satisfactory to WPP. As noted above, MEI has purchased the power station.

B. *The Monongahela Project*

This project is being developed by the Noah Corporation (Noah), a South Carolina corporation.

Noah has applied for a FERC license to operate a hydroelectric generating station at Lock & Dam No. 8 on the Monongahela River located near Point Marion in Fayette County, Pennsylvania. As a condition precedent to WPP's obligation to purchase energy and capacity under the Agreement, such FERC license must be issued no later than January 1, 1990. The Borough of Point Marion has also received an Order from FERC, issued April 3, 1986 at Docket No. QF86-413-000, certifying that the Project is a qualifying facility (QF) under PURPA and FERC regulations implementing PURPA. This FERC certification will be transferred or assigned to Noah no later than January 1, 1990.

At current annual mean river flow and at the expected average operating head, it is anticipated that the Project will generate energy at an average rate in the range of 17,100 to 20,900 megawatthours per year at a maximum gross design capacity of 5.0 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will

be delivered by direct interconnection with the WPP system.

Noah and West Penn executed an EEPA dated June 15, 1987, concerning the terms and conditions under which Noah will sell and WPP will purchase power from the Project. The EEPA appears in this record as WPP Exhibit 15. In general, the EEPA provides for the sale by Noah and the purchase by WPP of all energy produced by the Project for a term commencing on or after October 1, 1991, and all energy and capacity produced by the Project for a term commencing on or after January 1, 1992. The purchase price for such power consists of an energy component and, after the Project's Commencement Date (as defined in the EEPA), a capacity component.

The energy cost is a variable rate determined as set forth in Section 1.2(a) of the EEPA and, following the Commencement Date, in Section 1.2(b) and Exhibit A to the EEPA. Before the Commencement Date the purchase price for Project energy delivered to WPP shall be based on West Penn's fuel and maintenance expenses as shown in FERC Accounts 501 and 510-514.

After the Commencement Date, the energy cost for the first fifteen years is 3.8¢/Kwh unless the "Tracking Account," as provided for in Section 1.3 of the EEPA, is zero; thereafter (or during any time during the first fifteen years when the Tracking Account is zero) the energy cost varies depending upon the formula set forth in Exhibit A but will not exceed WPP's avoided energy costs as defined in the EEPA, unless such avoided energy costs are below 3.8¢/Kwh.

As set forth in Section 1.2(b) and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6¢/Kwh, based on an in-service date of the avoided capacity in 1995.

It is expected that in the early years of the EEPA WPP's payments for energy will exceed its avoided costs for energy. Therefore, the EEPA in Section 1.3 provides for a "Tracking Account" which will keep track of any energy cost payments over avoided energy costs. After the fifteenth year, the balance in the Tracking Account which is excess over avoided costs will be utilized in the form of credits against required payments. As of April 18, 1985, the date when WPP delivered its formal quotation to Noah, it was expected that any balance in the Tracking Account would be exhausted by about the end of the twenty-sixth year of the Agreement. Based on WPP's fuel cost projections as of the date of Execution of the EEPA, which are subject to change, it was expected that the Tracking Account will be exhausted by the end of the forty-third year of the Agreement. If the Tracking Account is exhausted during the Project term, WPP will thereafter pay an energy cost of 3.8¢/Kwh plus one-half the difference of the avoided energy costs over 3.8 cents per kilowatthour.

The capacity cost of 3.6¢/Kwh is approximately equivalent to WPP's estimate, as of April 18, 1985, of its levelized present value of avoided capacity over the life of the Project. WPP's methodology in determining this estimate is set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will be given a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, including the FERC license, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs, as of April 18, 1985, of APS, of which WPP is a member company.

The capacity costs to be paid to Noah are levelized over the Project term. The energy costs to be paid to Noah are front loaded. West Penn has not utilized front loaded energy payments in PURPA negotiations except for hydroelectric projects.

The levelization of capacity costs and the front loading of energy costs provides Noah with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost. The payback of the levelized capacity costs to utility ratepayers occurs in the later Project years the levelization begins to result in actual payments becoming lower than the projected avoided costs at such time.

For hydroelectric PURPA Projects, the energy costs exceeding avoided costs are recorded in a "Tracking Account" and may be recaptured in later years when avoided energy costs presumably will rise.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA for the life of the EEPA. As further conditions precedent, the Project's FERC license must be issued no later than January 1, 1990 and the Financing Closing Date, (as defined in the EEPA) must occur on or before July 1, 1990.

C. *The Burgettstown Project*

This project is being developed by North Branch Energy Partners, L.P. (North Branch) whose offices are in Greensburg, Pennsylvania. The General partner of North Branch is North Branch Energy, Inc., a Pennsylvania corporation with its principal place of business in Greensburg, Pennsylvania.

The project will consist of a coal-fired cogeneration plant with two circulating fluidized bed boilers, one steam turbine generator and related facilities, to be located in Robinson Township, Washington County, Pennsylvania, approximately 9 miles northeast from Burgettstown, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from North Branch, North Branch must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

It is anticipated that the Project will generate energy at an average rate of 91 megawatthours per hour. While the maximum Contract Output (as defined in the EEPA) is equal to 80 megawatts, the gross design capacity of the Project will be approximately 91 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the project will be fully dispatchable by WPP.

North Branch and WPP have executed an EEPA dated October 15, 1987, concerning the terms and conditions on which North Branch will sell and WPP will purchase power from the Project. A copy of the Agreement appears in this record as AAL Exhibit 24. In general, the EEPA provides for the sale by North Branch and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after April 1, 1991 and extending until the thirty-third anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after September 30, 1991, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's

Commencement Date, a capacity component equal to the Capacity Cost Rate for the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The capacity cost of 3.6¢/Kwh is slightly lower than West Penn's estimate of its levelized present value of avoided capacity over the life of the Project as of October 6, 1986. WWP's method in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of APS, of which WPP is a member company.

The capacity costs to be paid to North Branch are levelized over the Project term. The levelization of capacity costs provides North Branch with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the EEPA by fixing the Project revenues at a rate higher than current actual avoided

cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to North Branch should essentially equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the Agreement.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

D. *The Shannopin Mine Project*

This project is being developed by Mon Valley Energy Corporation (Mon Valley). Mon Valley is a Pennsylvania corporation with its principal office in Pittsburgh, Pennsylvania.

The Project will consist of a coal-fired cogeneration plant with a circulating fludized bed boiler and related facilities, to be located at Poland Mines, in Greene County, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from Mon Valley, Mon Valley must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

While the maximum Contract Output (as defined in the EEPA), is equal to 80 megawatts, the gross design capacity of the Project will be approximately 89 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the Project will be dispatchable by WPP.

Mon Valley and WPP executed an Electric Energy Purchase Agreement dated October 15, 1987, concerning the terms and conditions on which Mon Valley will sell and WPP will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 40. In general, the EEPA provides for the sale by Mon Valley and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after March 1, 1992 and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after August 31, 1992 and before the Commencement Date, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's Commencement Date, a capacity component equal to the Capacity Cost Rate for deliveries up to the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date the Capacity Cost Rate will be a fixed rate of 4.0 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The Capacity Cost Rate of 4.0¢/Kwh is slightly lower than WPP's estimate of its levelized present value of avoided capacity over the life of the Project as of September 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project, and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity costs and the actual energy costs of specified generating units of APS, of which WPP is a member company.

The Capacity Cost Rate to be paid to Mon Valley is levelized over the Project term. The levelization of the Capacity Cost Rate provides Mon Valley with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the early years of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the thirty-year life of the Project, the present value of the capacity payments to Mon Valley is slightly lower than West Penn's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

## *PHASE I PROCEEDINGS*

## III. DISCUSSION

### A. *The Legal Standard to be Applied*

Although the Commission has specific regulations governing the calculation of avoided costs, the rates set forth in the EEPAs in question were calculated under WPP's methodology. The parties differ about how to determine if the EEPA rates are at or below WPP's avoided costs.[7] Before discussing the parties' positions it is necessary to review briefly the legislation pertaining to non-utility generation.

PURPA became law in 1978. It is an attempt by Congress to increase the use of renewable energy resources and, in so doing, further this country's efforts to become energy independent. In PURPA, cogeneration facilities are characterized by the sequential production, from one fuel source, of electric energy and steam that can be used for industrial or commercial purposes. Small power production facilities are defined as those that produce electric energy by the use of biomass, waste or renewable resources and have a generating capacity of 80 MW or less. To encourage development of these facilities, Congress created a class of qualifying facilities that was to be exempt from the bulk of federal and state regulation.

Section 210 of PURPA, 16 U.S.C. § 824a-3(a), requires electric utilities to purchase power from cogenerators and small power producers (hereafter QF's). PURPA states that the rates for such purchase:

> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

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[7] The reasonableness of the energy rates has not been challenged; future references refer to capacity rates. See AAL Main Brief at 3.

> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

PURPA adds that:

> No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

16 U.S.C. § 824a-(b).

PURPA provides that a QF selling power is exempt from FERC provisions requiring general ratemaking approval for sales between electric utilities if the sales of QF power conform to an "incremental cost" standard. The term "incremental cost of alternative electric energy" is defined as "the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source." 16 U.S.C. § 824a-3(d). This rate standard has been termed by FERC, and generally adopted by the industry, as "avoided costs." 18 C.F.R. § 292.101(b)(6).

PURPA required FERC and State regulatory authorities to adopt rules governing the sale of QF power. As noted in footnote 1, *infra*, FERC and this Commission have done so.

The Commission's Order of September 29, 1988, page 3, defines the issue in this proceeding as follows:

> In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below WPP's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31, *et seq*. If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically recoverable from rate payers.

WPP maintains that the purchase rates in the EEPAs are below its avoided costs under either its methodology or

the Commission's regulations. For that reason, WPP concludes that the issue of what standard to apply is not critical. WPP Main Brief (M.B.) at 6-7.

The Projects insist that the formula in the Commission's regulations is the only legally recognized method of calculating WPP's avoided capacity costs. BM&S M.B. at 41-44. The Projects conclude that the reasonableness of the avoided capacity rate in the EEPAs must be measured against the avoided capacity rate calculated under the Commission's regulations.

AAL [8] insists that privately negotiated contracts are outside the scope of the federal and state cogeneration regulations, and it would be improper, therefore, to use those regulations as a standard against which to measure the justness and reasonableness of the rates in this proceeding. Instead, AAL argues that the capacity credits [9] negotiated by WPP must be below its true avoided cost and also provide "savings" to ratepayers under Section 527 of the Code. (AAL's Section 527 argument is discussed and rejected in Section III D 6 below.) AAL also argues that capacity payments under the Commission's regulations exceed avoided costs. AAL concludes that a correct determination of WPP's avoided cost is the initial benchmark against which privately negotiated capacity payments must be judged and that the Commission must insure that the negotiated rate is "some increment" below true avoided cost (its Section 527 argument). AAL M.B. at 37-48.

OCA argues that the Commission's regulations are not applicable to the rates established in the EEPAs of this case based upon the language of the regulations and the

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[8] Although AAL and WPPII each consist of more than one entity I refer to them in the singular.

[9] AAL uses the term capacity *credits* because the Commission's regulations use the same term. It is a confusing term, however, and I refer to them as capacity *payments* or *rates*.

*Milesburg* decision interpreting these regulations. OCA asserts also that because the regulations do not discount the future value of capacity in setting current rates, the regulations produce rates which are in excess of "incremental costs" and must be considered to violate the rate limitations set forth in PURPA. Even if it is determined that the regulations apply, OCA asserts, the regulations would produce a zero capacity rate as the regulations defining a committed unit or a proxy unit were inapplicable given the facts of this case. Finally, OCA argues that if it is determined that the majority of the WPP assumptions concerning the calculation of the capacity rates were valid, the rates under the regulations are still less than the rates provided for in the EEPAs as such rates should have been calculated based upon the selection of a combustion turbine (CT) rather than the WPP coal units. As a result, OCA concludes, the application of the regulations to the EEPA rates in this case does not support a determination as to the rates which should be approved.

In support of their positions, AAL and OCA rely on the same Commission and FERC regulations and on *Milesburg*. The FERC regulation at 18 C.F.R. § 292.301 (b)(1) reads as follows:

> Nothing in this subpart:
>
> (1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart.

The Commission's regulation at 52 Pa. Code § 57.32(a) provides that:

> Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities.

52 Pa. Code § 57.32(c) provides in part that:

> (1) Nothing in this subchapter:
>
> (i) Limits or extends the authority of an electric utility to agree to a price for a purchase or to terms or conditions relating to a purchase which differ from the terms or conditions which would otherwise be required by this subchapter.

In *Milesburg*, the Commonwealth Court discussed the relationship between privately negotiated QF contracts and the federal and state regulations as follows:

> The regulatory scheme adopted by FERC also permits utilities and QFs to negotiate agreements for utility purchase of power independently of the prescribed rates. 18 C.F.R. Section 292.301. Thus, even if a state chooses to implement the FERC regulations by adopting rules of its own prescribing a purchase rate in detail, a utility and a QF may still negotiate a different rate, using the state-prescribed rate as a base line. Because no large utility is exempt from the FERC regulation that requires filing of detailed utility cost data and projections with the State Regulatory Authority, 18 C.F.R. § 292.302, a QF negotiating an agreement with a utility knows what rate it could compel if the utility fails to bargain in good faith. Although privately negotiated contracts setting rates for QF power are essentially outside the federal and state rules, state public utility commissions have a duty to examine costs of such contracts claimed by a utility for the purpose of setting its own rates, and will disallow those found to be excessive. Therefore, the state regulatory authority plays an indirect role in the negotiating process.

*Milesburg* at 1300. AAL also relies on *Petition of Pagnotti Enterprises, Inc.*, P-870281 where the Commission in its August 18, 1988 Order, granting reconsideration of a previous order, stated as follows:

> Generally, however, negotiated agreements between utilities and QFs take precedence over the terms and conditions that otherwise could be required by our regulations.

Based on the foregoing, AAL concludes that it is a "point of law" that privately negotiated contracts are "essentially outside the federal and state rules" and that, therefore, it is improper to judge the reasonableness of the EEPA capacity payments by comparing them to rates calculated under the state regulations. AAL M.B. at 39. OCA concludes that the Commission and FERC regulations indicate an intention not to "affect" EEPAs voluntarily entered into and that rates calculated under the Commission's regulations provide no basis upon which the EEPA rates may be approved for recovery by WWP. OCA M.B. at 72-73. I disagree.

In *Milesburg*, the Commonwealth Court recognized that a utility and a QF may negotiate a rate different than that prescribed in the Commission's regulations, *"using the state-prescribed rate as a base line." Milesburg* at 1300. (emphasis added) A negotiated contract is "outside" the Commission regulations only to the extent it contains terms and rates other than those prescribed by the regulations. This does not mean the regulations cannot be used as a measuring rod. There is no "point of law" (whatever is meant by that term) that prohibits the Commission from concluding, as it did in its Order of September 29, 1988, cited above, that if the rates are at or below the avoided costs to which the QF would be entitled as a matter of law (i.e., as defined by the Commission regulations), the rates are *per se* reasonable. The formula in the regulations was promulgated by the Commission in response to the PURPA mandate. Until invalidated by the Commonwealth Court [10] or

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[10] WPP has challenged the validity of the Commission regulations computing capacity payments. The proceeding, at Commonwealth Court Docket No. 91 CD 1983, is pending.

changed by the Commission [11], the formula is the state-prescribed method of arriving at avoided costs and must be used by the Commission to judge the reasonableness of avoided costs set forth in agreements negotiated by a utility and a QF.

Anticipating reliance on the "base line" statement in *Milesburg*, AAL refers to it as follows:

> . . . it should be recognized that an *assumption* underlying this statement *must have been* that the state-prescribed rate under the state regulations would result in a capacity credit that was equal to true avoided cost.[6] However, as discussed *infra*, the testimony in this case clearly demonstrates that the capacity credits calculated pursuant to the state regulations invariably result in rates greatly in excess of avoided cost. Comparing a negotiated rate with a rate which is without question greater than true avoided cost is of no value. Thus, *the court must have intended* the parties to compare the negotiated rate with a rate which is an accurate determination of WPP's true avoided cost. (footnote omitted; emphasis added)

AAL M.B. at 40. AAL's reasoning is based on speculation. The issue of whether the Commission's regulations calculate rates in excess of avoided cost was not discussed by the Commonwealth Court in *Milesburg*. AAL is reduced, therefore, to judicial mindreading to support its position. This is most certainly a method inferior to interpreting the plain and clear meaning of the Court's words, namely, that the avoided costs set by the Commission's regulations can be used as a baseline against which to measure the rates set in the EEPAs in question.

OCA and AAL argue that the capacity payments calculated under the Commission's regulations cannot be

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[11] The Commission's proceeding at I-860025 is re-examining the cogeneration regulations and could result in changes in the formula.

used as a baseline because they exceed avoided costs. OCA M.B. at 73-80; AAL M.B. at 40-44. While they might be correct, this is not the correct proceeding within which to determine the accuracy of the Commission's calculation of avoided costs. As noted in footnotes 10 and 11 above, two other proceedings address this issue and it would be improper to rule on the accuracy of the regulations here. As noted, until invalidated by Commonwealth Court or changed by the Commission, the regulations are valid as they are.

Even though the regulations cannot be challenged here, and even though they can be used as a baseline, the evidence in this record does not support the use of calculations under the regulations *in these proceedings.*

Only WPP calculated avoided costs under the Commission's regulations. (The Commission Staff calculation (ALJ Ex. 1) was submitted without a sponsoring witness and carries no weight because it is hearsay evidence.) WPP's calculation, however, cannot be accorded much evidentiary value.

WPP witness Kave made the calculation even though he does not believe the calculation to be appropriate for the determination of WPP's avoided costs. WPP St. 1-S at 1. Mr. Kave noted that WPP has appealed these regulations on the basis that they overstate avoided costs. WPP St. 1-S at 2. When asked why he characterized his calculations of the rates under the Pennsylvania Regulations as estimates, Mr. Kave responded that:

> The actual calculation which would have to be performed for a more precise determination would depend upon a number of unknown factors. For example, the capacity rate calculation for a project would be performed at the time of acceptance by the qualifying facility (QF) [§ 57.34(c)(1)]. This could impact the determination of CB, the booked construction costs. I have no way of precisely know-

> ing on what date the QF would have accepted a calculation under the Pennsylvania Regulations.
>
> * * * *
>
> In addition, after initial rates have been established, certain adjustments occur to the capacity and energy rates . . . No attempt has been made to estimate these adjustments.

WPP St. 1-S at 3-4.

Owing to the nature of the calculation of avoided costs in the Commission's regulations and owing to the slight evidentiary value which can be given to the only calculation sponsored by a witness in this proceeding, the reasonableness of the capacity costs in the EEPAs in question should be measured against WPP's methodology, not the Commission's regulations. *This determination is limited to these proceedings.* It should not be applied to future proceedings where different record evidence is available.

B. *Burden of Proof*

The OCA in its Main Brief argues that WPP must meet a heavy evidentiary burden in this proceeding:

> The Pennsylvania Supreme Court has made it clear that the party with the burden of proof has a formidable task before its position can be adopted by the Commission. Even where a party has established a prima facie case, the litigant still must establish that 'the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, *precluding all reasonable inferences to the contrary*.' *Burleson v. Pa. PUC*, 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983) (emphasis added).

OCA M.B. at 16.

This proceeding is not a proceeding upon motion of the Commission and, therefore, the burden of proof enunciated in Section 315 of the Code, 66 Pa. C.S. § 315, does not apply. As the proponent of a rule or order, WPP has the burden of proof. Section 332(a) of the Code, 66 Pa. C.S. § 332(a). It is the duty of the party with the burden of proof to produce substantial evidence which, if believed, warrants the decision sought. *Smith v. Bell Telephone Co. of Pa.*, 397 Pa. 134, 139, 153 A.2d 477, 480 (1959). Substantial evidence is "that quantum of evidence which a reasonable mind might accept as adequate to support a conclusion." *Norfolk and Western Ry. Co. v. Pennsylvania Public Utility Comm'n*, 489 Pa. 109, 128, 413 A.2d 1037, 1047 (1980). No particular type of evidence is required; the only requirement is that the evidence as a whole be legally sufficient to support the order of the Commission. *Motor Freight Express v. Pennsylvania Public Utility Comm'n*, 180 Pa. Super. 622, 627, 121 A.2d 617, 620 (1956).

WPP's burden is not as formidable as OCA states it is. WPP must meet its burden of proof by substantial evidence, however, and the record in these proceedings will be examined in that light.

C. *Time Frame*

As noted, in the above History of the Proceedings, in its January 19, 1989 order, the Commission stated that the parties are free to argue that circumstances unique to these proceedings justify a departure from its policy that the appropriate time for determining avoided costs is the time during which serious negotiations take place.

WPP justifies its calculations of avoided costs as of the time of agreement in principle on rates and argues that AAL has not shown any unique circumstances to justify a departure from the Commission's policy. WPP M.B. at 44-51. The Projects cite the indicia of serious negoti-

ations enunciated by the Commission in *Pa. P.U.C. et al. v. Duquesne Light Company,* R-860556C001 (Order dated July 20, 1987) (*Duquesne*), and equate the serious negotiations standard to the period when WPP and the representatives of each Project discussed an agreement in principle on rates, but before WPP internally formulated the price. BM&S M.B. at 29-41. AAL argues that the Commission should use the time of the signing of the contracts in question because to do otherwise would deprive ratepayers of the consequences of two major tax changes which were enacted before the contracts were signed. AAL M.B. at 26-36. OCA uses WPP's agreement in principle dates. OCA St. 1 at 6-7; OCA M.B. at 19.

The negotiation process between a cogeneration project developer and a utility is lengthy and complicated. (See generally BM&S M.B. at 6, 8-10, 12 and the transcript and statement references made there.) WPP witness Kave describes WPP's negotiation process in WPP Statement 1, his direct testimony. He states as follows:

> West Penn is part of an integrated utility system known as the Allegheny Power System. The negotiation of PURPA contracts for West Penn and its sister companies, Monongahela Power Company and The Potomac Edison Company, is conducted on a centralized basis by the Allegheny Power Service Corporation ("APSC"). Since generation planning is done on a system-wide basis, avoided cost rates for eligible qualifying facilities are also determined on a system-wide basis. The paramount concern during such negotiations is that qualifying facilities who desire to avoid capacity must provide firm, reliable capacity at rates no greater than avoided costs.

WPP St. 1 at 4.

After a QF contact, WPP [12] receives information from the QF regarding size, type of project, location and schedule for deliveries. During later meetings to discuss purchase rates, project characteristics and negotiating guidelines, WPP tries to determine what the QF wants from WPP, if the QF can provide firm, reliable capacity, and if an agreement on purchase rates can be reached. If a price is agreed upon (the agreement in principle on rates), a formal Project Price Proposal, if approved by WPP management, is sent to the QF. This Proposal is an offer by WPP to purchase capacity and/or energy from the QF for a specific term and in-service date, subject to an ultimate agreement on all the terms and conditions. The proposal remains valid for a period of 3 months while negotiations are completed on the basic business arrangement, called a term sheet. Upon completion of a term sheet, customized for each project, a contract (the EEPA) is negotiated, drafted, finalized, and filed with the Commission for approval. WPP St. 1 at 4-5.

According to Mr. Kave:

> The crucial point in the negotiation process is the agreement in principle on purchase rates, which are recommended to senior management for inclusion in a formal Project Price Proposal. Prior to the acceptance of purchase rates, APS has very little confidence that the parties will be able to proceed with the transaction and that APS will be able to avoid the construction of capacity. Typically, a QF is unwilling or unable to commit to sell power in any amount or for any specific length of time absent an agreement on rates. On the other hand, once an agreement in principle on rates is reached and a QF is willing to proceed, APS believes, for reasons I will

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[12] In the following discussion APS and WPP are used interchangeably owing to the centralized negotiation of WPP's PURPA contracts.

> PURPA developer would commit to provide capacity if the rates were too low. Consequently, if there is no agreement on purchase rates, then there is no sound basis for avoiding capacity.

WPP at 10-11.

For the Milesburg Project an agreement in principle on purchase rates was reached in May 1986; a firm price proposal was sent on May 27, 1986. WPP St. 1 at 21. For the Burgettstown Project the dates are October 1986 and March 3, 1987, respectively. WPP St. 1 at 23. For the Shannopin Project the dates are September 1986 and October 17, 1986, respectively. WPP St. 1 at 24. For the Monongahela Project the dates are April 1985 and April 18, 1985, respectively. WPP St. 1 at 22.

AAL criticizes WPP's negotiation process, pointing out that its length renders the serious negotiations concept nebulous and allows for significant changes to take place which would alter the calculation of the capacity cost. AAL adds that during the negotiations of the EEPAs in question, interest rates fell, other projects negotiated with WPP, and two major tax changes were enacted. AAL then asks the question: "Should the QF developer be allowed to choose the point in time during the two years or so of 'serious negotiations' that generates the highest capacity cost rate?" AAL M.B. at 29. In my opinion, the correct response to this is another question: Should AAL be allowed to choose the point in the negotiation process that generates the lowest capacity cost rate? The answer to both questions is "no". Objective criteria are needed and must be applied consistently to give reliability (with respect to time frame) to utility/QF negotiations.

Next, AAL criticizes WPP for being bound by an oral agreement in principle as opposed to a written contract especially since the interim written documents, the term sheets, state that they are not binding regarding any

> explain later in my testimony, that there is sufficient assurance to assume that capacity costs will be avoided for planning purposes.

WPP St. 1 at 9. He explains why APS requires the QF to agree to a rate before issuing a Project Price Proposal as follows:

> By definition, avoiding capacity means that West Penn would include the QF capacity in the APS Integrated Resource Plan, defer or cancel new construction, and commit to a dependence on the QF capacity for serving its customers. Such a reliance on outside resources cannot be taken lightly. APS has received hundreds of contacts system-wide from new developers and existing cogenerators who have indicated a desire to sell power if acceptable terms could be reached. Less than 10% of these contacts have resulted in commitments to sell power. If all of these contacts, meetings, and negotiations were considered to be commitments to be included in the APS Integrated Resource Plan, West Penn's and APS's future plans would be nonsense.
>
> Experience has shown that there is no commitment to provide capacity until an agreement in principle on purchase rates is reached. Even then, the commitment is somewhat tenuous, and must be relied upon with caution. Consequently, we feel that capacity planning and the concepts of avoided costs require that agreement on purchase rates be the starting point for determining the level of commitment of potential PURPA projects.
>
> To issue a Project Price Proposal during exploratory discussions with the developer, when there is no commitment or agreement in principle on purchase rates, is unjustified. Practically all PURPA developers would commit to provide capacity if the purchase rates were high enough; conversely, no viable

provision including the price to be paid for Project Energy. AAL argues that WPP's ratepayers should not be bound long in advance of a written contract and "in defiance of beneficial changes" occurring before the contract is signed while the QFs are, as a practical matter, not bound at all. AAL M.B. at 31-32.

AAL's argument misses the point. The beneficial changes it refers to (particularly the Tax Reform Act of 1986 (TRA-86), which reduced the corporate federal income tax rate and the reduction of the Pennsylvania Corporate Net Income Tax (CNI) rate on January 1, 1987) could as easily have been detrimental to WPP's ratepayers. In other words, the tax rates could have been increased instead of decreased. If so, AAL, the two members of whom are WPP ratepayers, would probably argue in favor of a time earlier than the enactment of TRA-86 and the reduction of the CNI, a time such as agreement in principle on rates.

The reason for WPP's reliance on the time of agreement in principle on rates is that APS has determined, as a result of experience in negotiations with QFs, that at this time its risk of relying on a project's capacity for planning purposes is significantly reduced. WPP St. 1 at 9, Tr. 83-86, 297. This is important for WPP because it has a duty to serve its customers pursuant to Section 1501 of the Code, 66 Pa. C.S. § 1501.

On page four of its September 30, 1988 order in these proceedings, the Commission gave the reasons for its time frame policy:

> In order to prevent avoided cost rates from evolving into a constantly moving target, and to prevent utilities from depriving qualifying facilities of avoided cost rate entitlement by delaying negotiations, we consistently have evaluated avoided costs by reference to the time period during which serious negotiations take place . . . FERC's preamble to its regula-

> tions states, inter alia, that use of the term "legally enforceable obligation" is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility.

*See*, preamble to 18 C.F.R. §§ 292.304(b)(5) and (d), 45 Fed. Reg. 12224, February 25, 1980. There are other reasons to pick a consistently applied time frame. Most QF's depend upon their revenue stream from the utility to repay loans because most QF projects have very little equity invested. Accordingly, without a firm commitment on price from a utility, financing is difficult to obtain because lenders require evidence of a guaranteed revenue stream before financing the project. Without such a commitment to a revenue stream, contractors and engineers will be reluctant to submit bids on the project and the permitting process could be jeopardized. MEI St. 1 at 1-7; WPP St. 2 at 3-7; Tr. 8-9, 33-34, 393-394, 400-402.

Ultimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up. As noted, WPP sets the times of agreemnt in principle on rates as May 1986, October 1986, September 1986 and April 1985 for the Milesburg, Burgettstown, Shannopin and Monongahela Projects, respectively. I accept these dates as times when serious negotiations were taking place under the Commission's definition thereof as set forth in *Duquesne*. Under *Duquesne*, some indicia of serious negotiations are:

> (1) evidence of FERC certification granting qualifying status to the facility; (2) a statement of project definition including preliminary project design; (3) letter of intent or similar evidence of host site control; (4) evidence of adequate fuel supply consistent with anticipated project life and energy produc-

> tion; (5) a plan for obtaining all necessary project licensing; and (6) preliminary evidence of financial feasibility of project and a preliminary financing plan.

*Duquesne* at 5; See also *City of Pittsburgh v. Duquesne Light Company*, C-871584 (Opinion and Order entered October 6, 1988). While the list in *Duquesne* is not all inclusive, evidence of a project making substantial progress toward meeting the indicia can be considered as evidence of serious negotiations.

Based upon this record, for all projects, WPP's time of agreement in principle on rates meets the Commission's definition of serious negotiations. MEI St. 1 at 4-7; MEI Ex. 1; Tr. 88, 90, 101-102, 119; Burgettstown Sts. 5, 5-B and 6-A; WPP St. 1 at 23; Tr. 372, 1253; Shannopin St. 1; BM&S St. 1; Tr. 250-251. AAL has not shown any unique circumstances to justify a departure from the Commission's policy.

D. *The Reasonableness of the Capacity Rates in the EEPAs*

1. *WPP's Methodology*

WPP's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. WPP's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. WPP's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided

APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, showed that new, avoidable generating capacity would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of WPP's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problems. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlying information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, WPP maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged WPP's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs WPP used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that WPP's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, AAL and WPPII argue for EEPA capacity rates to be passed through to WPP's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

2. *Reserve Margin*

A reserve margin is the percentage by which a utility's firm energy resources exceed peak hour customer demand. OCA St. 1 at 21. WPP is part of the integrated APS system. Generation planning for the system is done on a centralized integrated basis. During 1985 and 1986, and at present, APS has defined its criterion for reserve margin as follows:

> No more than forty to sixty days DSCR (Dependence on Supplemental Capacity Resources) for APS; and a minimum of 25 percent installed reserves at time of winter peak.

WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220, upon Reconsideration, at 16); Tr. 1001.

The APS generation plan dated May 1, 1986 uses a 25% minimum reserve margin criterion and provides for three coal units of 300 Mw each which will come in service in October 1995, 1997, and 1998, respectively. WPP Ex. 8. These are the planned units which were used to compute the avoided capacity rates for the EEPAs in question. WPP St. 1 at 15-16, 20, 22, and 23.

AAL witness Falkenberg would revise the APS reserve margin criterion to 15 percent. AAL St. 3 at 16, 20, 30, and 35. OCA witness Biewald would revise the APS reserve margin criterion to 20 percent. OCA St. 1 at 35.

During its direct case, WPP relied on testimony and exhibits from three previous Commission proceedings which considered an appropriate reserve margin for WPP in conjunction with the Bath County Pumped-Storage Hydroelectricity Facility (Bath County). On November 30, 1984, WPP filed for a rate increase at Docket No. R-842632. *Pennsylvania Public Utility Commission v. West Penn Power,* 59 Pa PUC 552, 69 PUR 4th 470 (August 28, 1985). In large part, the proposed increase reflected the purchased power costs of Bath County.

WPP has included in its Ex. 16 in this case the testimony at Docket No. R-842632 of J. W. Geiser, Vice President of Planning for APS; and Homer T. McCarthy, Director, Generation Planning (now retired). WPP Ex. 16 at tabs 1, 2 and 3. Mr. Geiser's testimony contains a general description of the reserve margin criterion of APS. WPP Ex. 16 at tab 2 (WPP St. 11 in R-842632 at 11-12). Mr. McCarthy's testimony came in rebuttal during which he refuted the testimony of three experts: Messrs. Gerasimou, Falkenberg, and Baron. Among the arguments that Mr. McCarthy refuted was the claim of Mr. Gerasimou that because of APS' many transmission lines interconnecting with other utilities, it had ready access to capacity or energy during times of emergencies. WPP Ex. 16 at tab 3 (WPP St. 15 in R-842632 at 9-11).

The Commission did not approve recovery of the Bath County costs at R-842632 because the plant did not come on line during the future test year. On October 18, 1985, at Docket No. R-850220, WPP filed its second rate case generally relating to the recovery of the cost of purchased power from Bath County. *Pennsylvania Public Utility Commission v. West Penn Power*, 61 Pa PUC 711, 77 PUR 4th 220 (July 24, 1986). In the proceeding at Docket No. R-850220, the ALJ refused to reconsider the question of reserve margin criterion, and struck the testimony, *inter alia*, of Messrs. Falkenberg and Baron. This decision was affirmed by the Commission. 61 Pa PUC at 727-731, 77 PUR 4th at 236-239.

The Commission granted a petition to reopen the record and a petition for reconsideration to consider the effect of Section 1323 (signed into law on July 10, 1986) which deals with excess capacity. This resulted in another hearing (R-850220 Reconsideration) on the subject of the APS reserve margin criterion. WPP has included in its Ex. 16 testimony by Homer T. McCarthy; J. Robert Kissner, Manager, Load Forecasts; Albert F.

Kave, Jr.; J. F. Hose, Manager, Load Modification Program Planning; Kenneth J. Blasko, Manager, System Operations Engineering; and James E. Susman, Vice President of Energy Management Associates, Inc. WPP Ex. 16 at tabs 6-10.

As WPP notes (WPP M.B. at 15-16), the hearings at Docket Nos. R-842632, R-850220, and R-850220 Reconsideration covered the same period (1985 and 1986) relevant to these proceedings. As a result, the question of the APS reserve margin has been the subject of three sets of hearings and two pertinent commission orders. WPP emphasizes the direct testimony of Homer McCarthy offered in September 1987 at Docket No. R-850220 Reconsideration. WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220 Reconsideration). The first 21 pages of his testimony together with supporting exhibits contain a summary of the history of the development of the APS reserve margin criterion; the reasons for its adoption; its continued use by APS; and the use of the reserve margin in APS generation planning.

OCA criticizes this Bath County testimony as not concerning the planning reserve margin required *after* Bath County became a generating resource to APS. OCA M.B. at 20. OCA witness Biewald concludes that the WPP planning reserve margin should be no more than 20%. OCA St. 1 at 18-48.

Using WPP's dates for agreement in principle on rates, Mr. Biewald's analysis was done from the perspective of 1986 using the same method APS used in 1983 when APS last did a reliability analysis of its system. Mr. Biewald checked his analysis by referring to reliability goals set by the East Central Area Reliability Coordination Agreement (ECAR), of which WPP is a member, and other reliability councils. He used current generating unit unavailability data as of 1986, whereas WPP's last use of the program in 1983 used average unavailability data for the years 1976 through 1982. OCA St. 1 at

38-39. Using the updated unavailability data produces an average unit unavailability of 23.8% (as opposed to WPP's 27.4%). Applying this to the APS 1983 capacity reserve margin study produces a reserve margin of 16% to 20%. OCA St. 1 at 40-41; OCA St. 1 at Sch. BB-7.

The use of OCA's 20% reserve margin rather than WPP's 25% planning reserve margin delays the date when additional generating capacity is required to be brought on line by APS. An additional generating unit for APS would not be required in 1995, as projected by APS in 1986, but rather in 1998. The resulting capacity rate reduction from this change for Milesburg [13] would be from 3.12¢/Kwh to 2.45¢/Kwh, for Burgettstown from 3.73¢/Kwh to 2.98¢/Kwh and for Shannopin from 4.08¢/Kwh to 3.24¢/Kwh. OCA St. 1 at 48-49; OCA St. 1 at Sch. BB-11.

AAL attacks the studies supporting the APS reserve margin as outdated. AAL M.B. at 61-66. These studies are the 1981 General Electric over/under societal cost study, the 1984 EMA societal cost study, and the 1983 Capacity Margin Program probabilistic reserve margin analysis. Tr. 1001. OCA's attack on the EMA study appears at OCA M.B. at 38-39.

AAL witness Falkenberg concludes that in the 1986-87 time period APS could have achieved its reliability criteria of 40-60 DSCR with a 15% reserve margin. AAL St. 3 at 26; AAL Ex. 70. He performed a reliability analysis and compared it to the 1987 APS PROMOD III study. AAL St. 3; AAL Ex. 69. After determining that his model was similar to the APS model, he determined the DSCR levels resulting at various APS reserve margins. AAL St. 3 at 26, AAL Ex. 70; Tr. 1288. He then reaches the above conclusion: 40-60 DSCR at reserves of 15%. Mr. Falkenberg also updated the 1981 and

[13] The initial rate for Milesburg represents a corrected calculation to represent monthly EEPA payments. See Section I D 7 below.

1983 APS Capacity Margin Programs to account for improved generating unit availability, resulting in a 25% unavailability figure which translates to a reserve margin of 17% to 22% at 40-60 DSCR. AAL St. 3 at 33.

AAL supports Mr. Falkenberg's recommendation by arguing that it is consistent with planning reserve margins used by other utilities. *See* AAL M.B. at 70-72. AAL also asserts that a periodic updating of the APS planning reserve margin criteria is essential. In support, it points to a 1983 Commission mandated management audit of WPP recommending two year updates and criticizes APS for not updating its study before committing ratepayers to about $548,000,000 in additional capital expenditures resulting in a $52,557,121 annual rate increase (for all projects except Monongahela). AAL M.B. 72-77.

The Projects presented two witnesses who testified in favor of WPP's reserve margin requirement. In general, the Projects maintain that WPP's methodology conforms to standard industry practices widely accepted by regulatory commissions, that WPP's load forecasting technics result in competent forecasts, and that WPP needs a 25% planning reserve margin because it has an unusually large number of supercritical generating units and because WPP has a higher load factor than most other electric utilities. BM&S M.B. at 46-48.

In his rebuttal testimony WPP witness McCarthy reiterated the factors he considered when recommending to senior APS management the reserve criterion he used. He took into account the following factors:

1. The size of the system and size of the units within the system, particularly the fact that APS had ten super-critical units which ranged from 540Mw to 640Mw, each of which is about 10% of the APS system peak load. Tr. 859.

2. APS' high load factor. APS normally has one of the 10 highest load factors of the top 100 investor-owned utilities in the country. Tr. 860-861.

3. The availability of the units, including the improvement in availability in recent years. Mr. McCarthy rebutted the great significance placed on this improvement by Messrs. Falkenberg and Biewald by expressing concern that this level of availability may not continue for the following reasons: (a) the improvement may be in part due to temporarily higher operating reserves that allow lower levels of stress on individual units, (b) the equipment is aging, (c) extreme weather can result in availability problems, and (d) environmental factors such as possible acid rain legislation could significantly decrease availability. Tr. 861-65.

4. The continued doubt as to the actual availability of the PURPA projects over the terms of their contracts. Tr. 867.

5. The availability of power from other companies in the ECAR region. Although recognizing that APS had fairly high interconnection capabilities, Mr. McCarthy does not rely heavily on this factor because extreme weather conditions normally extend over a large portion of the region so all utilities in the region tend to be in need of power at the same time. Tr. 871-72.

6. The APS difficulty in maintaining adequate power supply during a period of very severe weather. As an example, Mr. McCarthy cited the winter peak of January 21, 1985, when power was not available from other companies in the ECAR region. Tr. 873.

In addition to these factors, Mr. McCarthy relies on experience and judgment to determine an appropriate reserve margin. He testified about this as follows:

> Q. Now, in reaching your judgment as to the appropriate level of reserves, are you—is the means by which you reached this judgment the computation of this 40 to 60 days per year dependence on supplemental capacity resources? In other words, my question, do you use a formula of some kind to reach this judgment, a final judgment of 25 percent?
>
> A. Do I use a formula?
>
> Q. A formula.
>
> A. No. Not necessarily a formula, no.
>
> Q. Would it be fair to say that you use a range of factors that you take into consideration?
>
> A. Yes. I think I—you know, I've been pointing out that many things go into the determination of what would be the appropriate reserve margin. Certainly, these—these studies, such as a capacity margin analysis, studies like what is termed over, undercapacity which indicates what the lowest cost to the customer would be at a certain reserve margin, these are tools that are used. But in addition to those, I apply experience and judgment from my years working with the company.

Tr. 880-81. *See also* testimony of David Nevius, Tr. 1214-1215.

Mr. McCarthy offered the following in response to being criticized for not performing a new formal study on the reserve margin criterion in 1986.

> While we had no formal study, we are continuously looking at all of the factors that would go into the determinations of a reserve margin, which we talked about today, all of these various factors, and what the situation would be, the uncertainties of the future, the uncertainties of forecasts, the weather sensi-

> tivity, what availabilities may be in the future, and what may occur with acid rain, and a host of other things and it was our judgment that 25—minimum 25 percent reserve margin was appropriate.

Tr. 877-878. Also, Mr. McCarthy testified that he and the other eight persons in the generation planning group devoted a significant part of their time in 1986 to the reserve margin criterion question. Tr. 878-79.

WPP successfully rebutted OCA's and AAL's argument that Mr. McCarthy's recommended planning reserve margin is out of line with other utilities and with the recommendations of the North American Electric Reliability Council (NERC) and its various regional councils, particularly ECAR. WPP Exhibit 17 and the testimony at transcript pages 720-727 show that a 25% reserve margin is not out of line with the industry throughout the United States and in ECAR. See WPP M.B. at 22-23. Also, I accept the testimony of David R. Nevius, Vice President of NERC, that there is no national norm of a 15% to 20% reserve margin criterion, as advanced by Mr. Falkenberg, and that there is not a usual assumption that a large, interconnected system has a reserve margin of 15% to 20%, as advanced by Mr. Biewald. Tr. 1211-12, 1215-16. Mr. McCarthy testified that other large, well-interconnected power systems have planning reserve margins of at least 25%. Penn Power (part of Ohio Edison) has a planning reserve margin of 25%, Philadelphia Electric at least 25%, and both Metropolitan Edison and Pennsylvania Electric (part of General Public Utilities) have planning reserve margins of 26%. Tr. 888. It is also Mr. McCarthy's understanding that the PJM pool is going to increase its reserve margin obligations from 22% to 25%. Tr. 889.

WPP Exhibit 17, the testimony of Nevius, and WPP Exhibit 19, the testimony regarding the reserve margins of other Pennsylvania utilities, demonstrate that the re-

serve margin criterion of WPP is not out of line with the industry.

WPP attacks Mr. Falkenberg's model, which changed between 1987 (when he focused on Loss of Load Probability (LOLP)) and 1989 (where he uses DSCR), because he did not disclose the nature of the changes. WPP also notes that Mr. Falkenberg did not submit data about his two models to parties requesting it. Tr. 1312-15. In addition, the model has not been used by any electric utility. AAL St. 1 at 4; AAL Ex. 63. For these reasons, and because it uses a time frame which I reject, *see* Section III C above, I give no weight to Mr. Falkenberg's 1989 model results.

OCA and AAL attack the factors considered by Mr. McCarthy at Tr. 861-65, referenced above. They are discussed below.

a. *High Load Factors and Super-Critical Generating Units*

OCA argues that if a properly determined probabilistic model is used to calculate an appropriate reserve margin, it is unnecessary to change the result to account for load and resource values already embedded in the model. OCA M.B. at 33-37. AAL witness Falkenberg, testifying in support of his probabilistic reserve margin, stated that any such program would take these factors (high load factor, super-critical units) into account. Tr. 1309-10.

Mr. McCarthy, Mr. Schultz and Mr. Depenbrock testified that the high load factors on the APS system support the proposed 25% reserve margin. Tr. 860; MEI St. 2 at 11; B&S St. 1 at 8-9.

Mr. McCarthy and Mr. Schultz also testified that the existence of super-critical coal generating stations on the APS system supports the APS proposed reserve margin of 25%. Tr. 860, MEI St. 2 at 10-11.

OCA has not demonstrated its argument with evidence and I have rejected Mr. Falkenberg's study for reasons given above. WPP has demonstrated that its high-load factors and super-critical generating units support its 25% reserve margin.

b. *Generating Unit Availability*

OCA asserts that Mr. McCarthy used the worst seven years of unit availability data for the 17 year period before 1986. It adds that using availability data for the entire period 1970 through 1986 produces a planning reserve margin of about 18% to 23%. Tr. 974-75. According to OCA, WPP has not supported its outdated use of relatively high unit unavailability rates given the range of rates experienced on the APS system during any period considered reasonable. OCA adds that much of the availability data WPP used predates Bath County, the inclusion of which in 1985 was expected to increase system reliability. AAL argues that the APS use of outdated unavailability data renders the 1983 capacity Margin Program an inappropriate tool upon which to base the calculation of capacity rates. AAL M.B. at 66.

I am satisfied, however, that Mr. McCarthy gave due consideration to the recent improvement in unit availability. In my opinion, in the use of his experience and judgment, Mr. McCarthy did not overstate WPP's reserve requirements for the reasons given during his cross-examination by OCA at Tr. 861-865. He believed that unit availability could decline as capacity margins decline and generating units are fired harder. Tr. 862-63. Lower reserves may result in less maintenance. Tr. 863. APS generating units were aging. Tr. 863. Acid rain legislation could be enacted. Tr. 865. All of these can reduce unit availability and Mr. McCarthy used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability.

c. *Acid Rain Legislation*

Besides Mr. McCarthy (Tr. 865, 991), MEI witness Schultz (Tr. 507, 1135) posited that pending acid rain legislation may require that additional generation units be built or that existing units be retired. OCA calls this reliance highly speculative and, noting that WPP would not apply the then impending TRA-86, argues that WPP should not be permitted to freely speculate on potential legislation as it chooses. OCA M.B. at 28-29.

There is a difference between TRA-86 and acid rain legislation as they pertain to these proceedings. WPP was correct in not incorporating TRA-86 because it was not enacted during the time of serious negotiations. This time frame is an objective guideline to give consistency to utility/QF negotiations as discussed fully in Section III C above. Whether or not to give weight to pending acid rain legislation in evaluating unit availability, however, is a subjective determination requiring judgment. It is no secret that the utility industry is concerned about acid rain legislation. Although such legislation might allow older generation units to remain in operation (Tr. 992), it could also have the opposite effect. Regardless of this, WPP used correct judgment in considering acid rain legislation as one of several reasons why current availability data might not hold in the future.

d. *Recommendation*

In ruling on the reserve margin question at R-842632 the Commission stated:

> In sum, Mr. Falkenberg recommended a reserve margin of 20%, and Mr. Gerasimou recommended a range of 16% to 19%. However, there is no magic number which applies to all utilities at all times. For example, in refusing to make an excess capacity adjustment for Pennsylvania Power Company, which had a reserve of 32.6%, we recently stated:

"The OCA has presented testimony and extensive argument in support of its recommended 20% reserve generating capacity which it characterizes as being an acceptable standard or benchmark in the electric generating industry. This commission, as early as 1972, urged a reserve capacity of at least 20% in *Pennsylvania Pub. Utility Commission v. Duquesne Light Co.*, 46 Pa. PUC 427, 437, 438, 97 PUR 3d 227, 232 (1972), in order '[T]o cover peak loads, scheduled maintenance, and forced outages in order to avoid blackouts, load curtailments, and voltage reductions.' We do not believe, however, that a capacity reserve margin of 20% or any other specific percentage could or should apply as an industry standard. *An acceptable reserve generating capacity margin for any particular electric utility is dependent upon the generation mix, availability of generating units, peak-load requirements, the period during which the peaking capacity is required, rates of forced outages, transmission capabilities, interconnections with other utilities and transfers of energy during emergency. These are some of the operating factors which must be considered when reaching a determination concerning an acceptable generating reserve margin.*" *(Pennsylvania Pub. Utility Commission v. Pennsylvania Power Co.*, 58 Pa PUC 305, 314, 60 PUR 4th 593, 601, 602 (1984).

The company in this case has presented substantial evidence that, under its particular circumstances, a reserve margin as high as 31% is appropriate, and we accept that judgment. (emphasis added)

59 Pa PUC at 573, 69 PUR 4th at 488. Although the Commission did not approve recovery of Bath County at R-842632, the above discussion is relevant here.

Forecasting a reserve margin requires the use of studies and computer analyses, but the final decision requires

informed judgment based upon experience. WPP produced witnesses and exhibits showing that the studies available when the 25% reserve margin decision was made, and the APS informed judgment based on experience related to events occurring between the time of the studies and the time of the decision, support the APS planning reserve margin which was used to set the avoided costs in these proceedings. I recommend that the Commission accept the APS studies and judgment and approve of the 25% planning reserve margin.

3. *Coal Unit v. Combustion Turbine*

In 1986, WPP projected that the next generating unit which it would construct would be a series of three 300 Mw coal units, the first of which would be brought on line in 1995. These projected avoided units served as the basis for setting the capacity rates for the Milesburg, Burgettstown and Shannopin projects. WPP St. 1 at 22-24. OCA witness Biewald determined that APS erred in planning to build three coal units as its next capacity resource. OCA St. 1 at 50-67. The OCA argues that in 1986 the APS system should have planned to construct oil or gas fired combustion turbines (CTs) to provide peaking capacity before constructing additional coal units. OCA St. 1 at 50.

In its generating mix a utility utilizes both base load plants, which generally offer high capital costs but lower fuel costs, and peaking plants, which offer lower capital costs but higher fuel costs. A mix of these resources economically meets the load of a utility system. A base load plant economically serves constant load which requires their use at a fairly constant level or at a high capacity factor. However, a base load plant cannot economically serve fluctuating peak load. A peaking plant, such as a CT, which will operate intermittently as peak load rises or falls, can most economically serve load which requires operation at a fairly low capacity factor. Thus,

while a peaking unit could not economically serve customer load at a high capacity factor, its operation is far more economic than that of a base load unit when serving incremental peak load. OCA St. 1 at 51; Sch. BB-4 at 4.

Mr. Biewald analyzed the APS system and concludes that it has been and was projected to be overly dependent upon base load capacity. From a fuel diversity perspective APS was also heavily dependent upon coal fired generation. Additional peaking generating resources fueled by oil or gas would have represented a preferable mix of fuel sources and would have increased fuel diversity on the APS system. Mr. Biewald recommends, therefore, that a CT unit, not a coal unit, should be used as the unit to be avoided by the QF capacity under consideration here. He adds that the net effect of adding a 300 Mw coal unit in 1995 would be to increase system operating costs. OCA St. 1.

OCA also criticizes the APS 1986 plans for a baseload coal unit because no formal study was done in 1986. OCA St. 1 at 54-56. Mr. Biewald contends that if such a study had been done, it would have shown a need on the APS system for more peaking capacity before any additional baseload because fuel oil prices had decreased. OCA St. 1 at 57.

OCA also attacks two studies completed by Mr. Geiser in 1984. They are studies upon which, according to Mr. McCarthy, APS relied to support the selection of a base load plant over a CT. OCA M.B. at 47-52. OCA claims that it is incorrect to use the dependent forced outages assumption in the second Geiser study (use of average forced outage rates in the first Geiser study produced results favorable to a CT). The dependent forced outage rate is designed to reflect the dependence of outage rates related to cold weather. Tr. 1701-02. Mr. McCarthy used the three highest monthly forced outage rates throughout the year, regardless of when they occurred, and assigned

these rates to the winter period in the APS production cost model. Tr. 1701. Thus, the dependent forced outage rates assigned to the period of the APS' winter peak were 2.33 times the average of the non-winter outage rates during the 1982-1986 period. Tr. 1697-1700. The actual winter outage rates were 11.5% for this period and 9.6% for the non-winter period. Tr. 1706-07. This reflects a much smaller outage difference than that used in the APS dependent forced outage rates. OCA argues that APS has misapplied the three highest monthly outage rates experienced on its system to the winter months as these high outage rates often occurred in non-winter months. Tr. 1702-03.

The OCA submits that APS could have but did not conduct a study to determine representative outage rates during the winter and non-winter months and then apply these rates in its production cast studies to the winter and non-winter periods. According to OCA, the results of the second Geiser study, and any other APS studies using dependent forced outage rates, cannot be relied upon to accurately project system cost results.

OCA also maintains that had APS done an accurate study in 1984 it would have had to be updated in 1986 to consider the change in oil prices occurring between 1984 and 1986. Doing so would have resulted in CTs being the preferable generating resource. OCA St. 1 at 57.

In response to OCA, WPP relies on Mr. McCarthy's testimony at Tr. 881-86 and 922-24. In developing the 1986 generation plan, Mr. McCarthy evaluated the possibility of adding combustion turbine capacity. Tr. 881-886. He considered the analysis done in 1984 which had indicated that the cost of combustion turbines was higher than the 300 Mw coal units. McCarthy explained that in the fall of 1985, when the 1986 generation plan was being developed, oil prices were just starting to decline, and APS had no assurance about what these prices would

be in the future. Tr. 882-84, 922. McCarthy also considered the availability of economical supplies of coal (Tr. 923) and the national and state policies of encouraging the use of coal, the Power Plant and Industrial Fuel Use Act of 1978 (Fuel Use Act). Tr. 881-82. Finally, McCarthy explained that APS' high load factor, approaching 90% daily, requires more baseload capacity because the equipment has to be loaded over long peaks. Tr. 923.

OCA counters that the Fuel Use Act provides for exemptions for peakload powerplants and that WPP acknowledges that CTs would be used as peakload plants. OCA M.B. at 52-56; Tr. 56, 946. Even so, Mr. McCarthy did not investigate constructing a CT under the Fuel Use Act exemption. Tr. 942-43. Also, other ECAR companies intended to bring CTs on line in 1992-1996. Tr. 854, 986; WPP Ex. 17.

OCA also disagrees with Mr. McCarthy's testimony about oil and gas prices. OCA submits that oil prices began to decline dramatically in 1985, and dropped quite low in 1986, but that Mr. McCarhty made no attempt to change the APS plans to build a coal unit. OCA St. 1 at Sch. BB-12. Also, Mr. McCarthy did not investigate the possibility of purchasing natural gas from producers or pipelines and transporting that gas to an APS generating facility for use in a CT. Tr. 987-88.

OCA argues against Mr. McCarthy's use of WPP's high load factor as a reason not to select a CT. It relies on testimony that APS CTs operate at low load factors. Tr. 938-39.

The Projects witness Mr. Ross criticized Mr. Biewald's method of calculation because:

> In order to properly evaluate the total cost of the resources, you must look at the life cycle. Otherwise, you will always choose a low capital cost, high operating cost resources, which may, and usually is, not the least cost resource.

Tr. 1183. The Projects maintain that by assuming that the oil-fired unit would be deferred for seven years, Mr. Biewald eliminated the need to compare operating costs for the entire 33 year life of the unit. This makes Mr. Biewald's method of comparing coal fired units to combustion turbine units weighted in favor of the unit with the lowest construction cost and the highest operating cost.

The Projects conclude that Mr. Biewald chose a methodology and assumptions that were calculated to give him the result he sought. He should have chosen a methodology and a set of assumptions which would provide a non-biased planner an opportunity to review the options on the basis of the costs over the entire period in which the avoided unit was to be used instead of just an arbitrary and hypothetical period between the installation dates of the two hypothetical units. Tr. 1195-1197; BM&S M.B. at 55-56.

OCA responds by pointing out that Mr. Ross did not submit a life cycle analysis and only supposes that the results would contravene Mr. Biewald's conclusions. As parties supporting the position of WPP, OCA argues that the Projects have the burden of proof and that this requires them to produce an analysis to refute Mr. Biewald's testimony. OCA concludes that the Projects failed to meet the burden of proof by failing to submit comparative cost analysis.

It should be noted that the OCA calculated its capacity cost using CTs by deferring the three 300 Mw coal units, the first of which was scheduled by APS to go on line in 1995, with 832 Mw of CTs. The use of 832 Mw of CTs was based upon WPP's own *1988* Resource Plan as filed with the PUC. OCA St. 1 at 56, 59. This usage of CTs was employed by Mr. Biewald as it represents the results of the first APS study done since 1984 in order to determine what its next generating resource should be. The use of 832 Mw of capacity

is derived from the WPP *1988* Resource Plan which recognized that under the best available projection of oil prices more than 832 Mw of peaking capacity was justified on the APS system. Tr. 836. The APS 1988 recommended addition of 832 Mw of CT capacity was based upon a high forecast of oil prices. Tr. 836.

Using a 25% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1995 to 2002. Using a 20% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1988 to 2006. OCA St. 1 at 60. In calculating the present value of future capacity on the APS system, Mr. Biewald reflected the lower capital costs of the CTs, being the first avoided generating units, and also the cost of the later avoided coal units as discounted to present value. OCA St. 1 at 60. While he defers the APS avoided coal unit from 1995 to a later date, he reflects the discounted cost of the avoided coal unit when it later reappears in the OCA generation forecast. In addition, Mr. Biewald has recognized the energy cost benefits associated with the QFs here at issue.

In Mr. Biewald's 25% reserve margin case, the recommended capacity rates based upon the use of CTs before bringing on line base load capacity changes from 3.12¢/Kwh to 2.02¢/Kwh for Milesburg, 3.60¢/Kwh to 2.50¢/Kwh for Burgettstown and 4.00¢/Kwh to 2.69¢/Kwh for Shannopin. In the 20% reserve margin case the recommended capacity rates based upon the same generating unit assumptions are 1.68¢/Kwh for Milesburg, 2.13¢/Kwh for Burgettstown and 2.28¢/Kwh for Shannopin. OCA St. 1 at 64.

The Commission's regulations, 52 Pa. Code § 57.34 (c)(4)(iii), define the proxy unit to be used in avoided cost calculations as follows:

> *System Reliability.* If a utility anticipates inadequate system reliability as a result of not being committed to sufficient plant during any period over the

next ten years, then the estimated construction costs of a new coal plant will be used as a proxy.

The criteria for commitment state that "[a] utility is considered to be committed to a plant if any of the following criteria are met: (A) The utility has spent 10% or more of the total estimated cost of construction or implementation; (B) The plant is due on line within 8 years, if a base load plant, or 5 years, if not a base load plant; [or] (C) Contracts have been signed for significant components of the plant." 52 Pa. Code § 57.34(c)(4)(i). WPP argues that at the appropriate time, WPP did anticipate inadequate system reliabiilty (i.e., a lower than adequate planning reserve) in the next ten years. But because at the appropriate time WPP did not plan to construct any non-base load plant which would come on line within five years nor any base load plant on line within eight years, and because WPP had no signed contracts for significant components of a new plant, WPP was not committed to a plant within the meaning of the regulations. WPP concludes that Section 57.34(c)(4)(iii) applies and the proxy plant is to be a new coal plant. *See also* WPP R.B. at 14-16. OCA interprets this Section differently. OCA M.B. at 18-26. A lengthy discussion of this is unnecessary because I conclude that under its methodology, WPP correctly selected a coal unit.

APS made its decision to use a coal-fired unit when the APS Generation Plan, dated May 1, 1986 was being formed. WPP argues that at that time, Mr. McCarthy took into consideration the many years of satisfactory service to APS and its ratepayers of coal-fired units (there is no record evidence of this); the drastic escalation in the price of oil and gas, even though tempered by a drop in such prices in late 1985 and early 1986; the results of studies which at best showed only a minor financial advantage for combustion turbines; the technological limitation on combustion turbines at that time;

and public policies and laws designed to encourage the use of coal. WPP aserts that all of this provided substantial evidence in support of Mr. McCarthy's decision to use a coal-fired unit as the capacity to be added in 1995. WPP R.B. at 13.

Although OCA's criticisms of the APS decision have some merit, they do not invalidate the experience and informed judgment of Mr. McCarthy. I conclude that WPP has submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in October 1995.

4. *Mitchell and Springdale Units*

WPPII argues that WPP's true avoidable resources is the renovated Springdale and Mitchell generating units, not three 300 Mw coal fired generating units. WPPII M.B. at 13-20. On April 11, 1983, West Penn filed a petition (Docketed at P-830434) with the Commission requesting permission to discontinue operations at the Springdale Power Station and Units 1 & 2 of its Mitchell Power Station. By Order of May 13, 1983, the Commission permitted West Penn to temporarily deactivate and place in cold reserve Springdale and Mitchell. By order of August 19, 1983, Springdale and Mitchell were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the 361 Mw associated with the Springdale and Mitchell units were not to be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. Order dated August 28, 1985 at Docket No. R-842632 at 45-46; WPP Ex. 15, Vol. I, Tab 5 at 20-21.

WPPII turns to the Commission's regulations which defines the plant to which the utility is committed as generating equipment, purchase power agreements, load management programs, or any other programs designed to meet the capacity needs of a utility. 52 Pa. Code

§ 57.34(c)(3). Next, WPPII notes that neither the Commission's regulations nor the FERC PURPA regulations require that the calculation of avoided cost or the EEPA capacity rates be based upon the costs associated with the construction of *new* generating capacity. WPPII asserts that although the Springdale and Mitchell units are existing units in the physical sense they are not available to serve customer demand and APS and West Penn must expend over $71 million to return the units to active service. Tr. 310, 314; WPPII Exs. 1-7.

Applying the criteria in 52 Pa. Code § 57.34(c)(4) (set forth in Section III D 3 above), WPPII argues that as of 1986 neither APS nor WPP was committed to the three 300 Mw units for the following reasons:

> As of 1986 APS and WPP had not spent 10% or more of the total $2.5 billion estimated cost of construction of the three 300 Mw hypothetical coal units. Tr. 43.
>
> APS and WPP have spent only $11 million toward the construction of these units. Tr. 42.
>
> In 1986 APS and WPP planned to construct and bring the three 300 Mw units in 1995, 1997 and 1998 respectively. Tr. 48.
>
> The first of the three 300 Mw coal plants was due on line in 1995 or within nine years; rather than eight year on-line criteria set forth in the Commission's regulations. Tr. 48.
>
> Neither WPP nor APS have let any contracts for the significant components of the plant. Neither WPP nor APS have let contracts for building the units or buying the generation equipment. APS and WPP have only retained UE & C to complete design work and prepare cost estimates. Tr. 43.

WPPII then applies the above referenced criteria to Springdale and Mitchell. In 1986 the renovation and

reactivation of Springdale and Mitchell was scheduled for 1992 and 1993 respectively. Tr. 313. In 1986, when the rates at issue were calculated, Springdale and Mitchell were due on line within seven years, or well within the eight year period specified by the Commission's regulations. Accordingly, APS and WPP were committed to the Springdale and Mitchell renovation and reactivation rather than to construction of the three 300 Mw units. According to WPPII, its conclusion is supported by the APS and WPP integrated resource plans, not the subjective opinion of an expert witness. WPPII M.B. at 18; WPPII Exs. 1-6.

WP witness Mr. Kave testified that WPP's generation plans indicate that the Springdale and Mitchell reactivation was always delayed until after PURPA projects came into service because the addition of PURPA capacity benefited ratepayers by delaying the costs of reactivation from as early as 1990 and 1991 to 1997 and 1998. Tr. 324. To this, WPPII responds that WPP ratepayers only truly experience the benefit of deferral of the reactivation costs of Springdale and Mitchell if the EEPA capacity rates are properly calculated based upon the $71 million renovation costs, not the $2.5 billion costs of the three 300 Mw coal units.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(iii), discussed in the previous section. WPP claims that the Generation Capacity Plan in effect at the time of the agreements in principle on rates in 1986 shows that WPP would need additional plant by 1995, *despite* the planned reactivation of the Mitchell units in 1992 and the Springdale units in 1993. WPPII Exs. 4 and 5. WPP concludes that in 1986, WPP was faced with inadequate system reliability within ten years, and it properly used the coal plant as a proxy. WPP Reply Brief (R.B.) at 16-17.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(i), which provides that

a utility is committed to a plant for avoided cost calculation purposes if it is a baseload plant which is due on line within 8 years or if it is a non-baseload plant which is due on line within 5 years. The Mitchell and Springdale units are oil-fired peaking units, which would only be used when WPP's coal-fired baseload plants are unable to handle the system load. WPP Ex. 16 at Tab 5 (WPP St. 9 in Docket No. R-850220 Reconsideration at 20-21; McCarthy testimony in Docket No. R-850220 Reconsideration, Tr. 1681). Because Springdale and Mitchell are non-baseload plants, and because in 1986 they were not "committed" units under the regulations, they were therefore properly not used as the proxy in WPP's avoided cost calculations. WPP R.B. at 17.

I agree with WPP's application of the facts in these proceedings to 52 Pa. Code § 57.34(c)(4)(i) and (iii). For these reasons, selection of the Mitchell and Springdale units is not mandated here. I do not conclude, as does WPP, that the regulations require the use of costs associated only with a new plant. WPP R.B. at 17-18. Under facts different than those presented here, the Commission might conclude that a plant in cold reserve must be used to calculate avoided costs.

5. *Fixed Charge Rate*

WPP uses a levelized annual fixed charge rate (FCR) to estimate the cost of owning capital assets. It is expressed as an annual percentage, effective for the life of the asset, and applied to the estimated original investment in the asset. In this case, the asset is the estimated original investment in the avoided facilities. The principal elements of the FCR are the cost of capital, depreciation, income taxes, insurance, and property-related taxes.

An FCR enables an engineer or analyst to make a comparison of the present worth of alternative courses of action without going through a detailed, year by year revenue requirement calculation. Tr. 1036. FCRs are

used throughout the APS system in all of the operating companies to do various engineering studies, *e.g.*, to determine the choice of energy supply equipment, and to determine whether to install new equipment or incur additional operation and maintenance expense. Tr. 1037. APS revises FCRs whenever conditions warrant; most revisions occur when the forecast of the future cost of capital is revised. Tr. 1037.

WPP used an FCR of 17.7% for all three Projects. AAL argues in favor of an FCR of 13.88% for the MEI Project and 14.65% for the Burgettstown and Shannopin Projects.

a. *Cost of Capital*

APS used the same cost of capital in the FCR that it uses throughout the APS system for economic studies. Tr. 1320-21. APS did cost of capital analyses for short-term and long-term projections. Tr. 1329. The cost of capital used by APS in the FCR for the avoided cost calculations at issue was a long-term projection. AAL Ex. 78. AAL witness Davila recalculated the cost of capital used by APS in the FCR, using a different capital structure, a different bond rate, a different cost of preferred stock, and a different cost of common stock. AAL St. 1 at 8-12. The major difference between WPP's determination of the cost of capital to be used in the FCR and Mr. Davila's approach is that WPP forecasts cost of capital, while Mr. Davila uses historical data. Tr. 615.

A treatise (by Robert Hahne and Gregory Aliff of Deloitte Haskins & Sells) on accounting for public utilities, which Mr. Davila attached to his prefiled testimony, AAL St. 1 at 7, recognizes the problems inherent in using historical data:

> The idea that historic data express factual conditions has sometimes led to the conclusion that those data are the most reliable data available for estimating

> future conditions. The factual nature of the events as recorded has apparently imbued the data with a degree of soundness and quality that appears to exceed a forecast approach for test year purposes. When conditions are in a state of change, historic data are likely to be the most unreliable in measuring test period conditions as a basis for future rate needs. While projected data using standard forecasting techniques may miss the mark, historic data, with a patchwork of updating, will surely miss the mark. As imprecise as forecasting may be, projected test year data based on reasonable forecasts should consistently come closer to expressing future conditions than will historic data as traditionally used.

Tr. 615-617; AAL St. 1, Appendix A at 3. I agree.

(1) *Capital Structure*

WPP correctly used its targeted future capital structure to determine its long-term projected cost of capital. Tr. 1043. Mr. Davila did not forecast APS' long-term capital structure. Tr. 605-607, 639, 643. In my opinion, it was incorrect for Mr. Davila to use the embedded capital structure from the WPP rate proceeding at R-850220 (Opinion and Order entered in July, 1986).

(2) *Cost of Debt*

APS forecasted future bond rates, whereas Mr. Davila determined bond rates by using an average over the last three months before the hearings in this proceeding. Although Mr. Davila claims that fluctuations tend to average out over the three month period (Tr. 637), WPP has shown that the use of a three month average to forecast future bond rates is unreliable because of the volatility of the bond market over time. WPP M.B. at 33-34; Tr. 607-08; WPP Ex. 22.

Mr. Davila criticizes WPP's bond rate calculation because APS's chief financial officer at the time, John

Adams (now retired), adjusted the seven year Data Resources, Inc. (DRI) bond forecast upward. Tr. 1045-48, 1270-83; AAL Ex. 78.

Between 1985 and 1986, DRI lowered its long-term bond forecasts by about one and a half percentage points. Tr. 1323. Mr. Adams did not adopt the DRI forecast in 1986, and did not drop forecasted bond rates as precipitously as did DRI. In not doing so, Mr. Adams used independent judgment and experience. Tr. 1280-83. Mr. Adams' judgment can be relied upon here owing to his being APS' chief financial officer for over 10 years and owing to his experience in raising capital for the construction of large coal-fired power stations. Tr. 1322. Mr. Davila acknowledged judgment and experience can be used in making long term forecasts. Tr. 1284-85. It turns out that Mr. Adams' experience and judgment were better than DRI's because its 1986 forecast of future bond rates has not been borne out by 1989 experience. Tr. 1284, 1325.

I recommend aceptance of WPP's cost of debt.

(3) *Cost of Preferred Stock*

APS deducted 100 basis points from its 11% cost of debt and arrived at a 10% cost of preferred stock. Tr. 1272-73. Mr. Davila would also use a three month average to determine the cost of preferred stock. AAL St. 1 at 11. His method is rejected, and WPP's method is recommended, for the reasons given in the above discussion on the cost of debt.

(4) *Return on Equity*

APS forecasted its return on equity by adding a risk premium of 400 basis points to the forecasted bond rates. This produced a return on equity of 15%. Tr. 1047-48, 1274-75; AAL Ex. 78 at 4c. The risk premium method is one of several recognized methods for determining the

cost of equity. It is universally recognized that investing in common stock is more risky than investing in bonds. It is assumed, therefore, that to encourage investment in common stock, it is necessary for a company to provide a higher return on common stock than an investor could get in the bond market. Tr. 615.

Mr. Davila supports the use of WPP's opportunity cost of equity determined in its most recent rate case. AAL St. 1 at 9. As WPP points out, this is not a valid forecast of future return on equity because there can be a long time between the rate case ruling and construction of the next generating station. Tr. 1047. WPP also demonstrates that the use of Mr. Davila's methodology in late 1981 results in a cost of debt higher than the return on equity granted in the last WPP rate case (15.8% debt versus 15.25% equity). Tr. 1048-49.

I recommend acceptance of the cost of equity forecast in WPP's FCR.

b. *State and Federal Taxes*

As AAL notes the resolution of this issue depends on the appropriate time frame for the determination of avoided costs. AAL M.B. at 59. AAL adds that even if its time frame is not adopted, WPP's avoided cost calculations are still in error because WPP should have known about and, therefore, used, the change in the federal tax rate in the spring of 1986 (AAL St. 2 at 16) and should have known about the change in the state corporate income tax rate as early as March, 1986. AAL St. 1 at 13. I have not adopted AAL's time frame (the time of signing of the EEPAs) and, therefore, I accept the tax rates used by WPP, namely, those in effect at the time of agreement in principle on rates (which is the same time as the serious negotiations standard of the Commission). *See* discussion at Section III C above. Also, as Mr. Kave pointed out, at the time the agreements in principle were reached, the language of the TRA-86

had not been finalized, hundreds of transition rules were being developed, and even tax experts did not know what the effects of TRA-86 would be. Tr. 115-16. Finally, changes in the tax laws after 1986 could not be predicted, and these changes could result in either increases or decreases in avoided costs. Tr. 306.

APS used the correct level of state and federal taxes in calculating its FCR.

c. *Ad Valorem Rate (Insurance and Property Taxes)*

WPP used a 1.3% ad valorem tax which included .3% for insurance and 1% as an average of property related taxes over the APS system. Tr. 1083. Mr. Davila analized property taxes paid as a percent of gross plant for the APS operating companies over the years 1985-1987. AAL St. 1 at 14; Tr. 621. He weighted the resulting operating company property tax rates to arrive at a system wide property tax rate of .52%. AAL St. 1 at 14. Mr. Davila did not include insurance costs as part of the FCR because insurance is included in the energy rate as part of operation and maintenance expenses. Tr. 651.

Mr. Davila did not, however, consider the effects of the Pennsylvania and Maryland Capital Stock Taxes and the West Virginia Business and Occupation Tax. Tr. 1055-56. Mr. Davila did not know if he took into consideration the Pennsylvania Capital Stock Tax, and also stated that he was not familiar with the Pennsylvania Capital Stock Tax. Tr. 622-23. Also, he did not consider the West Virginia Business and Occupation Tax. Tr. 623-24.

As WPP witness Binder explained, APS' tax liabilities under the Pennsylvania and Maryland Capital Stock Tax laws and the manufacturer's tax portion of the West Virginia Business and Occupation Tax are affected by the construction of a generation plant and are, therefore, properly included in the fixed charge rate. Tr. 1056-58.

AAL attacks WPP's 1.3% ad valorem tax for two reasons. First, .3% should not have been included for insurance because it is included in the energy rate as part of operating and maintenance expenses. Second, WPP has not documented the accuracy of its 1% assumption for the property tax rate.

To rebut the first reason, WPP refers to the EEPAs and to FERC accounts and regulations. WPP R.B. at 25. The EEPAs make clear that WPP's avoided energy costs are calculated based upon costs chargeable to FERC accounts 500 through 507 and 510 through 514. *See* the description of energy purchase prices, AAL Ex. 11, Section 1.2; AAL Ex. 24, Section 1.2; AAL Ex. 40, Section 1.2. *See also* the definitions of "Avoided Energy Cost Rate", "Average Production Cost Rate", "Variable Energy Cost Rate", and "Fixed Energy Cost Rate", AAL Ex. 11, Section 9.1; AAL Ex. 24, Section 9.1; AAL Ex. 40, Section 9.1. According to the FERC's regulations, the 500 through 507 and 510 through 514 accounts cover certain operation and maintenance expenses involved in steam power generation. *See* 18 C.F.R. Part 101 for a description of these FERC accounts. I agree with WPP that Mr. Davila's position on insurance costs is inconsistent with the terms of the EEPAs.

To rebut the second reason, WPP refers to FERC accounts and regulations once again. WPP R.B. at 25-26. The insurance costs included in the ad valorem rate represent property related insurance. Tr. 1081-82. Under the FERC's regulations, 18 C.F.R. Part 101, property insurance costs are chargeable to account 924, and not to one of the 500 series accounts enumerated in the EEPAs:

> 924 Property insurance.
>
> A. This account shall include the cost of insurance or reserve accruals to protect the utility against losses and damages to owned or leased property used

> in its utility operations. It shall include also the cost of labor and related supplies and expenses incurred in property insurance activities.

WPP concludes that because the property-related insurance costs were not included in the calculation of the avoided energy cost rate, and because the property-related insurance is a relevant cost associated with avoided capacity, it was proper for APS to include the property insurance costs in the ad valorem rate when APS was calculating its FCR. I agree.

I recommend acceptance of the ad valorem rate in the APS FCR.

d. *Rate Base*

The calculation of the year by year revenue requirements for determination of an FCR requires the use of a rate base. Tr. 1038-1041; WPP Ex. 21. A year by year revenue requirement is calculated by adding, among other things, the annual book depreciation plus the cost of capital and applying a present worth factor. Tr. 1040; WPP Ex. 21.

WPP used a beginning of the year rate base, but Mr. Davila modified WPP's revenue requirement calculation to reflect an average rate base. AAL St. 1 at 6-7; AAL St. 1, Appendix A at 3. The average rate base model he used, however, does not include discounting to present worth. Tr. 620. The revenue requirement calculations done by Mr. Davila and APS are necessarily discounted to present worth, Tr. 617-18, 1041, and, therefore, require a different model than the average rate base model. Tr. 1041-42. As Mr. Binder demonstrated, Mr. Davila's model has the anomalous result of making the book depreciation plus the cost of capital, discounted to present worth, yield a result lower than the initial investment. Tr. 1040-41; WPP Ex. 21. This conflicts with Mr. Davila's acknowledgement that the book depreciation plus the cost of capital, with appropriate discount factors applied, should equal the initial investment. Tr. 617.

Mr. Davila's method is rejected and WPP's is accepted. Mr. Davila's method is flawed for the above reasons. WPP's method, which is different than the average rate base model, is correct for developing an FCR for cost recovery over an extended period. Tr. 1038-1042; WPP Ex. 21.

e. *Recommendation*

In consideration of the above, I conclude that WPP's FCR is calculated correctly. I recommend its acceptance.

6. *Section 527 of the Code*

AAL argues that, in Pennsylvania, purchases from QFs must be less than avoided costs because Section 527 of the Code, 66 Pa. C.S. § 527, mandates that the purchases must result in savings to the ratepayers. AAL M.B. at 47-48.

Section 527 provides that:

> The commission shall promulgate rules and regulations concerning the rates, terms, conditions and availability of cogeneration in this Commonwealth. The commission shall require that utility rates to the public reflect savings to the utility from cogeneration.

In rejecting AAL's position in its Order on Reconsideration entered January 19, 1989, the Commission stated as follows:

> Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's full avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. (emphasis in original)

Mimeo at 6. In response, AAL argues that since in fact there can be no savings to the ratepayers with the use of

the full avoided cost standard, logic dictates that Section 527 was intended to apply where the full avoided cost standard does not apply, i.e. in the case of the voluntarily negotiated contract.

AAL agrees with the conclusion of the Commission that "absent a voluntary agreement otherwise" Section 527 would be preempted by federal PURPA standards. But, if Section 527 is to have any application at all, AAL concludes, it must mean that in cases such as those under consideration where there is a voluntarily negotiated contract, the Commission must find that there are savings which result to the utility's ratepayers. AAL R.B. at 21.

AAL is engaging in legislative mindreading with no support except stretched logic. If Section 527 cannot be applied to the avoided cost calculated under the Commission's regulations it also cannot be applied to a voluntary agreement where, as determined by the Commission, the rates are set at full avoided costs. Besides, the record here demonstrates that the EEPA rates are below WPP's avoided costs so, even though not mandated by Section 527, there already is a savings passed on to the ratepayers.

The second sentence of Section 527 has no application to avoided costs set under the Commission's regulations or under negotiated contracts.

### 7. *OCA's Correction to the MEI EEPA*

OCA argues that the Milesburg EEPA capacity rate should be reduced from 3.3¢/Kwh to 3.12¢/Kwh to reflect the monthly payments made under the contract. OCA M.B. at 66-70. Mr. Biewald testified that the MEI capacity rate calculation is inconsistent with the calculation used for the Burgettstown and Shannopin projects. For these later two projects, WPP added a Step 8 to calculate the time value of money effect of paying the QFs for their power monthly. The Milesburg rate, how-

ever, was calculated as if the payments were made annually. OCA St. 1 at 9.

OCA argues that to reflect the value of the QF capacity to the WPP ratepayer, which capacity was scheduled to go on line in 1990 under the EEPA but would otherwise not be required by WPP until 1995, the actual monthly payments to Milesburg must be reflected in the discounting formula. Mr. Biewald testified as follows:

> Like the Burgettstown and Shannopin projects, Milesburg will receive energy payments on a monthly basis. For that reason, I have used the same methodology for calculating the Milesburg payments that I used for calculating the Burgettstown and Shannopin payments. My use of the refined methodology shows that the proposed Milesburg rate is above the level that would result from the Company's own current calculation methodology.

OCA St. 1 at 9.

Mr. Kave, a WPP witness, seems to confirm Mr. Biewald's adjustment. He testified as follows:

> Q. Mr. Kave, but would you agree that under the West Penn Power formula, when the Milesburg rates were calculated, West Penn was using an annual payment assumption in determining those rates?
>
> A. The methodology that was in use at that point in time calculated the capacity rates available to any project on the basis of an annual capacity rate.
>
> Q. And when the Burgettstown and Shannopin rates were calculated, West Penn Power had gone to a monthly payment assumption, is that correct?
>
> A. I have a little difficulty with your words payment assumption, but I think that's correct.
>
> Q. Let me try to be very specific. In the West Penn Power method you use a mathematical formula which makes certain assumptions as to the frequency

with which the QFs would be paid for their capacity, is that correct?

A. Generaly that's correct.

Q. And again, for Milesburg it was annual, for Burgettstown and Shannopin it was monthly?

A. That's correct.

Q. In fact, are each of these three projects to be paid on a monthly basis under their contracts?

A. Yes.

Q. And if you were—let me rephrase that. Holding all other assumptions equal, if you were to calculate a rate based on an annual payment or a monthly payment, how would those rates differ?

A. The monthly payment rate would be smaller.

Tr. 69-70.

Although all three projects rates are the result of negotiated contracts, there is no evidence in this record to support using a different method to calculate the MEI rates. The MEI EEPA was first in time. After it was executed, WPP added Step 8 to its calculation in the other EEPAs. Without Step 8, the MEI capacity rate calculation is flawed because under it payments are made monthly but calculated as though made annually. The MEI rate does not accurately reduce the cost of future capacity to present value and does not, therefore, render ratepayers indifferent to paying for WPP's capacity or for a QF's capacity.

WPP's Reply Brief is silent on this issue. MEI points out that WPP's methodology was not amended until after the MEI calculation was finalized. MEI claims that by requesting a hindsight change in WPP's methodology, OCA is engaging in a selective modification of the methodology. BM&S R.B. at 34-35. This is an interesting argument in light of the nature of MEI's petitions to modify its EEPA. MEI is wrong. The calculation of its EEPA rate is incorrect. WPP should have used Step 8 and inserting it now is a correction, not a hindsight

modification. I recommend that the MEI EEPA capacity rate be reduced from 3.3¢/Kwh to 3.12¢/Kwh. This assumes the Commission resuscitates the MEI EPA which has lapsed. *See* discussion in Section IV A below.

8. *Capacity Costs Allocated on a Demand/ Energy Basis*

Presently, QF capacity payments are recovered from ratepayers through the ECR on a straight energy basis and, therefore, allocated to WPP's customers on the same basis. AAL and WPPII advocate for recovery of QF capacity payments from ratepayers on a Kw demand basis through the ECR but in a manner similar to that which would have occurred if such capacity had been built by the utility and the costs were included in base rates and allocated according to cost-of-service principles. AAL M.B. at 79-86; WPPII M.B. at 20-25.

Noting that were WPP to construct the avoided units (base load coal units), the costs would be allocated in base rates on a demand basis, AAL witness Baron recommends that the long term capacity purchases from the three Projects be accorded the same rate treatment. He suggests use of the same demand allocation method used by WPP in its most recent cost-of-service study, updated to the 12 month period ended June 30, 1986. AAL St. 2 at 24. Although the June 30, 1986 12 month period represented the most recent information available, Mr. Baron strongly encouraged WPP to update its analysis with recent data since the cost-of-service information is a number of years old. AAL St. 2 at 28.

The reasons for using a demand/energy allocation are sound. First, as long as rate recovery is accomplished through the ECR, the method of allocating QF purchase costs to the ratepayers will have no effect on the amount of revenue collected by the utility and passed through to the QF. Second, without a demand allocation of capacity payments ratepayer indifference is lost because high

load factor customers (usually energy intensive customers such as the members of AAL and WPPII) pay higher rates for cogenerated capacity than for utility generated capacity. Third, the current practice of recovering QF capacity payments through the ECR is contrary to accepted cost-of-service ratemaking principles.

OCA recommends that AAL's proposal be rejected. OCA M.B. at 88-92. OCA argues first that the AAL rate structure proposal would add complexity to the calculation and charging of WPP's ECR.

Second, OCA argues that AAL's proposal is based on the inaccurate assumption that QF capacity rates should be allocated based upon a single WPP coincident peak, the method used in the last WPP case. Tr. 687-688. OCA points out, however, that in R-850220, the last WPP rate case, the rate increase was allocated on an energy basis for Bath County costs and a rate reduction related to non-Bath County was also allocated on an energy basis. Tr. 689-90. Also in R-842632 the Commission rejected a staff proposal to use only the coincident peak method. *Pa. PUC v. West Penn Power Company*, 59 Pa. PUC 552, 609 (1985).

Third, OCA agrees with WPP witness Binder that the AAL method of allocating capacity related costs based upon a single coincident peak may result in volatile changes in cost allocations depending upon peak responsibility for a single day. Tr. 1031. Also, Mr. Baron agreed that the cost responsibility allocations provided in the next West Penn base rate case may also indicate the need for additional changes in cost allocations based upon new cost data. Tr. 697-98, 703.

Finally, OCA notes that the rate structure issue is not one which the Commission has set for decision in this case and may be analyzed more appropriately in future base rate or ECR proceedings.

In my opinion, AAL and OCA are both correct. The capacity costs should be flowed through to WPP rate-

payers, via the ECR, on a demand/energy basis, but the allocation should not be set in this proceeding. Any complexity brought to the ECR calculation is outweighed by the true reflection of costs which will result.

It is clear from this record that the current method of using the ECR without a demand/energy allocation discriminates between classes of customers and does not meet the PURPA-mandated standard of customer indifference to the source of capacity. *In re: Middle South Services, Inc.*, 71 PUR. 4th 580, 594, 33 FERC ¶ 61.408 (1985). There is precedent for a demand/energy allocation. The West Virginia Commission allocates the QF capacity costs of Monongahela Power Company (WPP's sister utility) on a demand basis within the fuel adjustment clause. Also, the Virginia State Corporation Commission, in Case No. PUE-880052, concluded that QF capacity costs should be recovered through base rates on a demand/energy basis. AAL St. 2 at 26-27. AAL's method, is flawed, however, because the single coincident peak method has not been used in past WPP rate cases, because it may result in volatile changes in cost allocations, and because Mr. Baron used stale data.

Because the costs in question will not be recovered through WPP's ECR until the next ECR proceeding, and because AAL's method and data are flawed, this is not the appropriate proceeding in which to set the demand/energy allocation. It is the proceeding, however, in which to declare that capacity costs for WPP's QF purchases should be flowed through to WPP ratepayers via WPP's ECR on a demand/energy basis and I so recommend. I recommend also that WPP be directed to make such an allocation, as part of its next ECR filing and that all existing on-line QF capacity at the time of the filing be included. Under Section 1307 of the Code, 66 Pa. C.S. § 1307, the Commission has the authority to direct WPP to do this. To extend this ruling to other electric utilities, however, must await a separate proceeding. It could

be done in the generic cogeneration investigation (I-860025) where the Commission is considering the issue of demand/energy allocations through the ECR.

9. *Excess Capacity*

In its MEI Petition, WPP asks the Commission to find that addition of the MEI capacity "does not result in excess capacity under Section 1323 of the Public Utility Code as to the MEI capacity itself or as to any *existing* West Penn capacity". West Penn Petition at 5-6 (emphasis added). In its Order of September 22, 1987 granting rate approval to West Penn concerning the Milesburg project, the Commission stated that: "the Commission hereby declares that additional generation capacity as a result of the contract between West Penn Power Company and Milesburg Energy, Inc., referenced in ordering Paragraph No. 1, above, shall not be considered by the Commission in determining the reserve margins or economic benefits resulting from *any base load or other generating unit during the terms of the contract*." Order at 7 (emphasis added).

The Commonwealth Court held that the "Commission may not make such a decision without first providing the ratepayers with notice and hearing." *Milesburg* at 1308. By the Court's remand, therefore, the excess capacity issue, as it applies to all four EEPA Petitions, must be addressed here.

The OCA submits that in this proceeding the Commission should adopt a policy concerning any further excess capacity adjustments to be made on the WPP System. The OCA also asks the Commission to declare that QF capacity *will* be considered in determining whether *subsequent* utility plant additions represent excess capacity. OCA M.B. at 82-87.

Mr. Biewald presented testimony upon the issue of how capacity provided by QFs should be taken into account when determining whether excessive capacity exists

upon a utility system. OCA St. 1 at 68-76. He generally distinguished between excess capacity determinations which take into account generating capacity constructed before and after the utilities' commitment to a QF generating resource. OCA St. 1 at 72-76. Mr. Biewald stated that it is essential to consider QF capacity in deciding whether utility capacity constructed *after* the utilities' commitment to a QF should result in an excess capacity determination. He explained that to do otherwise would double charge ratepayers for QF capacity as they would pay once for the actual QF and once again for excess utility capacity that was to have been avoided by the QF. The utility should not be permitted to charge ratepayers for capacity when it is clear from the generating resources available to it (excluding QFs) that such additional capacity is not required. Mr. Biewald concludes that:

> Thus we reach a very simple conclusion: at least some excess capacity analyses, namely those concerning future utility resource additions, must treat QF capacity in *exactly the same manner as utility-owned capacity*.

OCA St. 1 at 73 (emphasis in original).

Mr. Biewald rejected the Commission's Proposed Policy Statement, issued for comment in the *Pennsylvania Bulletin* on July 18, 1987 at Docket No. L-870030, which declared that QF capacity ought to be included in excess capacity evaluations, only where utilities imprudently bring capacity on line when the existence of the QF would have permitted delay or cancellation.

The OCA submits that the Commission should make clear in these proceedings that it does not intend to adopt its Proposed Policy Statement. The reasons in support of OCA's position appear in OCA M.B. at 85-87. I do not summarize them here because these are not the correct proceedings in which this determination should be made. Comments to the Proposed Policy Statement have

been filed and a final Commission determination is pending in that proceeding (L-870030). While the Commission might or might not choose to follow its proposed policy in these proceedings, a blanket determination is proper in the proposed policy proceeding, not here.

I recommend a finding that addition of the QF capacity in question does not result in excess capacity under Section 1323 of the Code as to the capacity itself or as to any existing WPP capacity.

10. *Capacity Rate Recommendation*

Based on the above discussion I recommend approval of the Monongahela EEPA at an initial energy rate of 3.8¢/Kwh and a capacity rate of 3.6¢/Kwh. I recommend approval of the Burgettstown EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 3.6¢/Kwh. I recommend approval of the Shannopin EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 4.0¢/Kwh. The rates for Burgettstown assume that the Commission adopts my recommendation, discussed below, to deny the Burgettstown Petition to extend deadlines and to update capacity rates.

I recommend that the Milesburg Petition be denied for the reasons discussed below. If the Commission rejects my recommendation, I recommend that the capacity rate be reduced in accordance with the discussion at Section III D 6 above.

I recommend that WPP be directed to include in its next ECR filing a demand/energy allocation for all QF capacity on-line at the time of the filing of the ECR.

*PHASE TWO PROCEEDINGS*

## IV. THE PETITIONS FOR MODIFICATION

The second phase of these proceedings consists of a hearing to consider two petitions filed pursuant to Section 508 of the Code, 66 Pa. C.S. § 508 which reads as follows:

> Power of the commission to vary, reform and revise contracts
>
> The commission shall have power and authority to vary, reform, or revise, upon a fair, reasonable, and equitable basis, any obligations, terms, or conditions of any contract heretofore or hereafter entered into between any public utility and any person, corporation, or municipal corporation, which embrace or concern a public right, benefit, privilege, duty, or franchise, or the grant thereof, or are otherwise affected or concerned with the public interest and the general well-being of this Commonwealth. Whenever the commission shall determine, after reasonable notice and hearing, upon its own motion or upon complaint, that any such obligations, terms, or conditions are unjust, unreasonable, inequitable, or otherwise contrary or adverse to the public interest and the general well-being of this Commonwealth, the commission shall determine and prescribe, by findings and order, the just, reasonable, and equitable obligations, terms, and conditions of such contract. Such contract, as modified by the order of the commission, shall become effective 30 days after service of such order upon the parties to such contract.

The reader is referred to the History of the Proceedings (Section I above) which relates in part to these petitions and which is not repeated in its entirety here.

A. *MEI's Petitions*

Currently pending in Phase Two of these proceedings are four separate but related Petitions and Motions: 1) the February 8, 1989 Petition for MEI for Modification of An Electric Purchase Agreement; 2) the March 14, 1989 WPP Petition for Leave to Withdraw its original Petition; 3) the March 13, 1989 Motion of AAL to Dismiss the original WPP Petition seeking rate recovery for the costs incurred under the WPP/MEI Agreement; and 4) the May 12, 1989 Petition of MEI for Modification of Petition to Modify Electric Purchase Agreement. The March 3, 1989 Petition of MEI for the Issuance of an Interim Emergency Order or Appeal was denied by Commission Order entered March 31, 1989.

MEI's February 8, 1989 Section 508 Petition requested that the Commission modify MEI's privately negotiated contract with WPP in two ways: 1) to increase the levelized capacity cost rate contained in the Agreement to reflect a delayed in-service date for the project (now anticipated to be in mid-1993. MEI St. 5), or in the alternative, to approve a non-levelized capacity rate; and 2) to extend the Agreement's Financing Closing Date to not later than 120 days after a final and nonappealable Order of the Commission giving approval for recovery of all energy and capacity costs, and all other milestone dates as appropriate.

MEI advances several arguments in support of its position. First, extension of the milestone dates is reasonable, fully supported and justified because:

a) of extensive and unprecedented delays due to litigation of the reasonableness of the EEPA before the Commonwealth Court and the Commission;

b) the Consent Agreement issued by the Commission on September 1, 1988 shows that all parties recognized a likelihood of further extension of the milestone dates;

c) extension of the milestone dates is essential to survival of the MEI Project;

d) in its March 31, 1989 Order, the Commission stated that the EEPA "could be reinstated by extending the financing deadline *nunc pro tunc*, for example, by modifying the contractual provision so that it is not self-executing." Order, at 8.

e) failure of the Commission to modify the EEPA would curtail cogeneration development in Pennsylvania;

f) MEI will suffer a financial loss of millions of dollars without extension of the milestone dates;

g) the Commission recently enunciated a policy of encouraging the extension of contractual milestones in *Petitions of Pennsylvania Electric Company*, P-890353, P-890354 (Opinion and Order entered April 6, 1989);

h) WPP requested MEI to agree to EEPA modifications by letter of February 13, 1989 but WPP refused MEI's request to modify the EEPA despite MEI's requests and the ALJ asking WPP if it would agree to voluntary negotiations on the EEPA (at the March 31, 1989 prehearing conference);

i) the MEI project will benefit the citizens of Pennsylvania and the local community;

k) extending the milestone dates will produce no demonstrable risk to WPP's ratepayers and will not cause planning uncertainty on WPP's system;

l) extending the dates will not result in payments in excess of avoided costs and will not discriminate against other QF's.

Second, modification of the capacity rates from 3.3¢/Kwh to 4.9¢/Kwh is reasonable and justified because:

a) without it the project cannot survive because since the Commission approved the Project in September, 1987, interest rates and the cost of construction and borders has risen substantially;

b) the modification requested by MEI is not in excess of WPP's avoided cost;

c) under the circumstances of this case it is inappropriate to update all of WPP's assumptions because MEI is asking only for an update of the in-service date of the project;

d) MEI's request will not result in uncertainty for financing entities;

e) MEI's request will not cause widespread use of regulatory out clauses (requiring utility payments to QFs only if the utility receives money from its ratepayers for that period).

The testimony and exhibit references as well as the full argument of the Projects in support of the above appear at pages 66 to 84 of the BM&S Main Brief. MEI's arguments are not discussed further because the MEI contract has lapsed and cannot be changed under Section 508. Even so, many of the issues raised by MEI's petition are similar to the Burgettstown Petition and are discussed in Section IV B below.

One of the key original provisions in the EEPA between WPP and MEI, Section 10.2, provided as follows:

> "If the Financing Closing Date shall not occur prior to September 1, 1988 for any reason whatsoever, including *Force Majeure*, this Agreement shall automatically terminate in which case neither party shall have any further liability to the other hereunder."

Immediately before the September 1, 1988 automatic termination of the Agreement under Section 10.2, the parties to the Milesburg proceeding entered into a Consent Agreement which resulted in a Consent Order issued by the Commission on September 1, 1988. AAL Ex. 80.

This Consent Order extended the September 1, 1988 Financing Closing Date to February 28, 1989 and provided as follows:

> The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible commencement date, in the said agreement that is dependent on the said Financing Closing is extended for a like period. *Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.* (emphasis added)

The Financing Closing Date was not extended by further order of the Commission before February 28, 1989 because MEI did not file its petition soon enough for Section 508 to be used to modify the EEPA before the deadline. The question before me, therefore, is whether Section 508 empowers the Commission to retroactively reinstate the MEI EEPA which automatically terminated under its own terms.

WPP, AAL and WPPII argue that because the contract MEI seeks to modify has lapsed, there is no contract to modify and Section 508 does not apply. WPP M.B. at 79-80; AAL M.P. at 88-89; WPPII M.B. at 26-27.

In my view, this is a contractual issue because Section 508 gives the Commission the "power and authority . . . to vary, reform, or revise . . . any terms, or conditions . . . of any *contract* . . . between any public utility and any . . . corporation" (emphasis added). There is no contract between WPP and MEI upon which the power vested in the Commission by Section 508 can operate. Section 508, therefore, is inapplicable here. MEI does not address this point and it has advanced no legal authority to support the retroactive modification of a contract which no longer exists.

In its Order entered March 31, 1989 denying MEI's Emergency Petition, the Commission stated with respect to MEI's Section 508 Petition that "should MEI prevail, the Electric Energy Purchase Agreement between MEI and West Penn could be reinstated by extending the financing deadline *nunc pro tunc,* for example by modifying the contractual provision so that it is not self-executing." Order at 8. The proper function of a *nunc pro tunc* order, however, is to make the record speak the truth. Such an order corrects the record so that it truly reflects an action really taken, but which through some inadvertence or mistake has not been recorded. *In re: Jurkowitz Estate, Pa.,* 59 A.2d 895 (1948); *Matthies v. Railroad Retirement Board,* 341 F.2d 243 (8th Cir. 1965). *See also* 2 Am. Jur. 2d, Administrative Law § 521. In my opinion, the Commission's observation about the application of the doctrine of *nunc pro tunc* is incorrect because there is no existing Commission judgment before February 28, 1989 to be corrected by the doctrine. Even if the consent order could be considered as a Commission judgment, an order *nunc pro tunc* would be inappropriate because there is no mistake in the consent order and nothing was inadvertently omitted from it.

I note also that the Consent Order specifically precludes higher capacity payments. Paragraph 3 of the Consent Order reads as follows:

> MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

AAL Ex. 80. I reject MEI's argument that the consent order does not bar increased capacity rates. MEI argues that because the modified rates are below the rates which would be calculated under WPP's methodology or the regulations, these do not represent an increase in rates. BM&S R.B. at 47-48. It *does* represent an increase in

capacity rates. MEI's petition should be denied for this reason also.

MEI argues that the legally enforceable obligation of WPP to purchase energy from MEI is not dependent on the existence of a contract. The obligation exists pursuant to PURPA which requires the utility to purchase energy from a QF at rates as of the time that there is a legally enforceable obligation, as defined by state law. (45 Fed. Reg. 12224). According to MEI, WPP misreads 18 C.F.R. § 292.304(d) as requiring this proceeding to be viewed strictly under contract law. That section refers to the utility's legal obligation to purchase from the QF, whether or not a contract is in effect. The QF has the option, before commencement of the term of the agreement, to choose whether it wants its avoided cost payments based on time of delivery or the time the obligation is incurred. (18 U.S.C. § 292.304(d)(2)(i) and (ii)). MEI concludes that, in Pennsylvania, WPP is compelled to purchase from MEI from the time serious negotiations took place. For MEI, that obligation was formed by May, 1986 or earlier. BM&S R.B. at 46.

While it appears that WPP is required by PURPA to purchase power from MEI, WPP is not required to do so under the lapsed EEPA. To require WPP to purchase its power, MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations.* MEI's argument does not resuscitate the lapsed contract.

It is clear that the MEI Project would be beneficial to the Commonwealth. It will allow for the reclamation of land on which coal waste is stored. It will provide needed employment in the Belefonte area, perhaps improve water quality there, help pay for part of the improvement of a railroad bridge and provide business for a local railroad company. MEI St. 4. It is also clear that MEI could not have foreseen the delays caused by litigation. This is a risk that any developer must bear,

however. Despite the obvious equities in favor of the MEI Project, the EEPA does not exist and cannot be approved. If the Commission disagrees, the EEPA should not be modified for the reasons given above and in section IV B below.

I recommend that MEI's Petition for modification be denied and that WPP's Petition to withdraw and AAL's Petition to dismiss be granted. That leaves MEI's May 12, 1989 Petition to modify its petition to modify.

MEI's May 12, 1989 Petition is a petition to modify a petition to modify a contract that no longer exists. MEI's Petition seeks the same type of modification sought by North Branch. *See* Section IV B below. Through it MEI seeks to avoid business risks which it voluntarily accepted in the EEPA. A discussion of the merits of the May 12, 1989 Petition is unnecessary because the underlying contract, the EEPA, has lapsed and cannot be modified. I recommend that MEI's May 12, 1989 Petition be denied for this reason and for the same reasons for which the Burgettstown Petition should be denied.

B. *The Burgettstown Petition*

As in the MEI Petition, the North Branch Petition (for the Burgettstown Project) is in two parts. First, it asks for modification of milestone dates and second, it asks for an increased capacity rate to reflect the new in-service date. This discussion will also refer to the Milesburg Petition because the issues raised by both Petitions are similar, even though the MEI EEPA has lapsed.

In the Burgettstown EEPA, the capacity credits are based on the QF being placed in service on October 1, 1991. If it is not placed in service by October 1, 1993, Burgettstown will be in default. Based on those dates, Burgettstown is to have a financial closing on October 1, 1989 and is to make a final good faith deposit of $360,000 on July 1, 1989. According to North Branch, the developer of the Burgettstown Project, these dates

were agreed to on October 15, 1987 based on a belief that the pass-through provisions of the EEPA would be ruled on favorably by the Commission as was done in the Milesburg Project (by order entered September 22, 1987). After that, however, appeals were filed with the Commonwealth Court which resulted in a decision that bill insert notice needed to be sent to ratepayers and due process hearings needed to be held. Due to those unforseen circumstances, North Branch notes, there has been a year and a half period during which no meaningful engineering, financing or construction activity could take place.

Due to this delay, North Branch filed its petition for modification so that, according to North Branch, the now unrealistic milestones in the Project may be modified so as not to jeopardize the project while, at the same time, protecting WPP's generation planning study.

Mr. Brooks testified that construction of the plant from the date of financial closing would take approximately 33 months. Tr. 1368. This testimony was not rebutted. Mr. Hoehler testified that it would take approximately six months from the date of a final order to have a financial closing. Thus, assuming that a final unappealable order were to be issued in this case on October 1, 1989, a closing could not be held until approximately April 1, 1990 and the plant could not be constructed and placed in service until approximately January 1, 1993. North Branch concludes that if its Project is to be approved, the contract dates must be modified. BM&S M.B. at 85.

Paragraph 18 of the North Branch Petition sets forth the specific EEPA modifications requested and reads as follows:

> 18. Due to the delay caused by the intervenors, the following dates in the Agreement must be modified as follows:

a. "Financial Closing Date" shall be defined as six (6) months from the date of a final order in this proceeding.

b. The second sentence of Section 2.1 of the Agreement shall be modified to read as follows:

"The parties currently estimate that with the exercise of such diligence Seller shall be able to place the Project in service at the Contract Output no later than thirty three (33) months from the Financial Closing Date.

c. Section 6.1(a) shall be modified to change the event of default date as follows:

(a) the Commencement Date shall not occur prior to fifty-seven (57) months from the Financial Closing Date or October 1, 1995 whichever is earlier.

d. The final Good Faith Deposit of $360,000 shall not be due until three (3) months prior to the Financial Closing Date.

e. All dates which relate to the above dates shall be adjusted automatically.

f. The capacity credit shall be modified to be the avoided capacity credits calculated pursuant to West Penn's PURPA 210 filing of July 31, 1986 and calculated as of the modified in service date in Section 2.1 of the Agreement which is set forth in subparagraph 18b. hereof.

The parties have litigated this issue thoroughly. BM&S M.B. at 87-89, R.B. at 35-49; WPP M.B. at 81-87, R.B. at 32-46; AAL M.B. at 95-99, R.B. at 46-48; OCA M.B. at 93-97, R.B. at 31-32.

I note first that although the North Branch Petition seeks a modified capacity credit based upon WPP's July 31, 1986 PURPA filing with the Pennsylvania Commission, the supplemental testimony of Mr. Ross on behalf of Burgettstown (Burgettstown St. 7) does not calculate a modified capacity credit on that basis. Instead, Mr. Ross calculates increased rates based upon the WPP method for calculating avoided costs under the assumption of a later in-service date for the QF. There is, therefore, no testimony to support the capacity rates requested in North Branch's Section 508 Petition. The North Branch Petition does not specify a requested capacity credit, and the supplemental testimony of Mr. Ross sets forth an increased capacity credit based upon a methodology which is different than that requested in the Petition. There is no way of knowing, therefore, what rate North Branch is requesting. The Petition should be denied for this reason. There are, however, other reasons why the Petition should be denied.

The North Branch Petition requests an open-ended modification of the Financial Closing Date (six months from the date of a final order in this proceeding, instead of October 1, 1989); requests an open ended in service date (no later than 33 months from the Financial Closing Date, instead of between April 1, 1991 and October 1, 1991); requests an open ended event of default date (57 months from the Financial Closing Date or October 1, 1955 whichever is earlier); and requests that all related dates be adjusted automatically. This is unlike the February 9, 1989 MEI petition which requests extension of the Financing Closing Date to no later than 120 days after a *final and nonappealable order of the Commission.* North Branch's extension is not predictable. It is doubtful that any appeals taken from the Commission's Order could be litigated within six months. This applies also to MEI's May 12, 1989 Petition.

North Branch cites *Petition of Pennsylvania Electric Company Re: X10X Corporation,* Docket Nos. P-89035

and P-890354 (April 6, 1989) as enunciating the Commission's policy of encouraging voluntary extensions of financing and/or commercial operation or related deadlines. It suggests that WPP's actions are contrary to that policy. BM&S M.B. at 43. But, as WPP points out, the Commission also observed that orderly capacity planning is a legitimate concern of utilities:

> Our discussion should not be read as discouraging utilities from utilizing *reasonable* milestone dates in their contracts with qualifying facilities. A concern independent of the reasonableness of rates paid to qualifying facilities is the need by a utility to plan its capacity additions to match its anticipated load growth.

Opinion and Order, April 6, 1989, at 7 (emphasis in original).

The question to be resolved is whether WPP's refusal to agree to the extensions is motivated by lack of support for the projects (this issue applies to Milesburg also, if the Commission resuscitates the MEI EEPA) or whether it is motivated by the desire to avoid significant planning uncertainties and impairment to its ability to serve its customers if the projects fail to go into commercial operation. Resolution of this issue turns on the risks to be borne by the parties.

WPP's Main Brief, pages 60-67 contains an excellent discusison of the dynamics of the lengthy and complex negotiation process leading to the EEPAs and how the EEPAs address how the risks are to be borne by all affected parties, including the project lenders, constructors, operators, WPP and its customers. I have attached these pages as Appendix A and incorporate them herein.

Many observers are concerned that electric utilities are hostile toward cogeneration because it impairs their control over their generation, generation planning and return on rate base. The record in this proceeding does

not demonstrate this hostility, if it exists generally, on the part of WPP or APS. What the record does demonstrate is a deep concern on the part of both that the EEPAs allow them to insure that, at important stages of development, the project is progressing and that if it is not they can take steps to safeguard their system reliability and generation needs. This is vital in light of WPP's duty to serve the public under Section 1501 of the Code, 66 Pa. C.S. § 1501. The Projects argue that the contract was not truly negotiated because WPP was inflexible regarding the EEPA. The record does not demonstrate this. Also, if the Projects felt that way they could have opted to sell their power to WPP under the Commission's regulations.

WPP did grant a limited extension to MEI in the Consent Order entered by the Commission on September 1, 1988. The extension requested by North Branch for the Burgettstown Project, and by MEI, however, are not for short, limited periods of time at the price originally negotiated. Instead the developers request prolonged extensions covering periods much beyond those originally negotiated by the parties and at increased capacity rates. This changes the planning risk WPP negotiated in the EEPAs.

WPP witness Albert Kave testified that the planning risks associated with reliance on a proposed QF project decrease significantly at two points: at the time of agreement in principle on purchase rates and at the time of the financial closing. WPP St. 1 at 9; WPP St. 4 at 5; Tr. 83-86 and 297. Neither of these projects have had a financing closing and the proposed extensions provide no assurance that a financing closing date will occur within a reasoable period of time. The proposed cutoff date for the Burgettstown project's in-service date of October 1, 1995 (as well as the cutoff date of January 1, 1995 recently proposed for the Milesburg project in MEI's May 12, 1989 Petition) does not provide WPP with enough planning certainty regarding these projects.

WPP would have insufficient time before its planned need for capacity to replace these projects if they should fail to go into service by the proposed cutoff dates. The extensions would push the Burgettstown financial closing deadline to as late as late 1992 or early 1993 because construction of the project will take at least 30 to 33 months. Tr. 1368, 1400. Judging from the history of these proceedings there is the likelihood that a party or parties will seek review of the Commission's final order in the Pennsylvania courts and perhaps in the federal courts. If so, it is highly unlikely that either MEI or North Branch will meet any of the extended deadlines. This further increases the risk to WPP and its ratepayers that WPP will be unable to arrange alternative sources of power.

It can be argued that even without the increased capacity rates, the extensions benefit WPP ratepayers because of the postponement of payments. It would be useless to approve the extensions without the increased rates, however, because the developers have made it clear that without both, the projects will fail.

The developers argue that the extensions are needed because they have spent millions of dollars on the projects and because the projects are in jeopardy owing to the delays in these proceedings resulting from *Milesburg*. The amount of money spent on the projects does not mean they will go into service. The developers were always at risk that, no matter how much money they spent, WPP's obligation under the EEPAs would cease upon a missed milestone date. *See* AAL Ex. 11, Sections 5.7 and 10.2; AAL Ex. 24, Sections 5.7 and 10.2. It is clear that the business "deal" between WPP and the developers placed the risk of construction related cost increases on the developers at all times, even if those cost increases were to render the projects infeasible.

The delays in Commission approval of the EEPAs, while the fault of neither WPP or the developers, is a

risk to which the developers have always been subject. Even so, the developers are requesting a higher capacity rate to offset cost increases which occurred during the delays. It is incorrect to shift this burden to the ratepayers because it was not part of the original business arrangements, the EEPAs. The developers' petitions should be denied for this reason.

Another reason for denying the petitions is the lack of consistency. The time frame argument of the cogenerators in Phase One above favors the time of serious negotiations for the following reasons, enunciated at BM&S Main Brief at 34-35:

> Mr. Ross testified that "it is inappropriate and inequitable for the parties who have negotiated an EEPA in good faith, *based on the circumstances occurring during the time that serious negotiations were taking place, to be held accountable for knowing the outcome of the future events.*" (BM&S, St. 1 at 17-18). If a QF and a utility agree on rates based upon projections of a utility's avoided cost as of the time of serious negotiations, *and those rates are later modified to reflect changed circumstances . . .* the economic feasibility of the project as well as the goal of PURPA will be frustrated.
>
> * * * *
>
> The projects have *refrained from using hindsight* by not extracting data from a time period other than the time of serious negotiations by each party (emphasis added).

In Phase Two, however, Burgettstown and MEI argue for higher capacity rates to reflect changed circumstances existing in 1989. It is inconsistent for the cogenerators to argue on one hand that TRA-86 should not be considered in calculating avoided costs while arguing on the other hand that negotiated capacity payments should be increased because of unforeseen events occurring in 1989, which events delayed the project in-service dates.

If the developers are permitted to modify the negotiated EEPAs here because of unforseen events, the contracts between WPP and the cogenerators become meaningless. Such a decision will lead to a reluctance of utilities to negotiate such contracts in the future. Of course, the denial of modifications should work both ways. That is, if avoided costs decrease after a contract is signed, the utility should not be allowed to modify the contract to reduce the capacity costs. Such a policy instills consistency and predictability in the utility/QF relationship which should foster the growth of reliable QF projects.

I recommend that, for the above reasons, the North Branch Petition be denied. The above reasons also support denial of the MEI Petition, denied above for other reasons.[14]

C. *Notice to Ratepayers*

AAL argues that WPP was required under Section 508 of the Code to send out notices that a rate modification was requested and that the notice which was sent previously to WPP's ratepayers is insufficient. AAL M.B. at 93-95, 98. I discuss this issue, even though modification is denied above, because it is relevant to future proceedings.

At times a utility changes the level of its Revenue Requirement during a base rate proceeding owing to data updates. A new notice is not required because the original notice is sufficient to notify all interested parties of the prospective change in rates and gives them an opportunity to participate. WPP's bill inserts accomplished the same purpose. The modification requests here are no different than a changed level of rate relief in a base rate proceeding. Accordingly, neither MEI nor North Branch were required to issue new notices.

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[14] North Branch and MEI can resort to the Commission's regulations to sell their power to WPP.

## V. RECOMMENDED ORDERS

I recommend that the Commission issue four separate orders in these proceedings. No apeal from the Monongahela Petition is possible if the petition is approved as applied for because no party contested that petition. Including all petitions in one order, however, could delay the Monongahela Project unnecessarily if any party appeals from the Commission's Order.

### A. *Recommended Milesburg Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-870216 to withdraw its Petition at Docket No. P-870216 for approval of an Electric Energy Purchase Agreement entered into with Milesburg Energy, Inc. (for the Milesburg cogeneration project) is granted.

2. That the Petition of Milesburg Energy, Inc., filed February 9, 1989 for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the Petition of Milesburg Energy, Inc., filed May 12, 1989, for modification of the Petition referenced in paragraph 2 of this order is denied.

### B. *Recommended Monongahela Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880283 for approval of an Electric Energy Purchase Agreement entered into with Noah Corporation (for the Monongahela Lock and Dam No. 8 cogeneration project) is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

C. *Recommended Burgettstown Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880284 for approval of an Electric Energy Purchase Agreement entered into with North Branch Energy Partners, L.P. (for the Burgettstown cogeneration project) is granted.

2. That the Petition of North Branch Energy Partners, L.P. for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

4. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

5. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under

cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

6. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

D. *Recommended Shannopin Mine Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880286 for approval of an Electric Energy Purchase Agreement entered into with Mon Valley Energy Corporation (for the Shannopin Mine cogeneration project )is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

Date: June 8, 1989 /s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

## APPENDIX I

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17120

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Docket No: P-870216, P-880283, P-880284, P-880286

Public Meeting—September 21, 1989
SEP-89-ALJ-124 *

PETITION OF WEST PENN POWER COMPANY (WPP) FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS (EEPAs) AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS RE: MILESBURG ENERGY, INC.; MONONGAHELA LOCK & DAM NO. 8; BURGETTSTOWN PROJECT AND SHANNOPIN MINE PROJECT

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### MOTION OF CHAIRMAN BILL SHANE

Before the Commission for disposition is Administrative Law Judge (ALJ) Larry Gesoff's Recommended Decision in the above captioned proceedings.

After thoroughly reviewing the ALJ's Recommended Decision (R.D.) and the Exceptions and Reply Exceptions filed thereto, I believe we should adopt the ALJ's Recommendation regarding "Phase I" issues, with minor modification, and reverse the ALJ's recommendations concerning "Phase II."

*Phase I*

1. *The reasonableness of rates in negotiated contracts generally is to be judged by a comparison to rates that would be required under the Commission's regulations. R.D. at 38-41.*

This is a fundamental concept that has been the basis for all of the Commission's Orders approving rate recovery of amounts to be paid to Qualifying Facilities (QFs) under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the general investigation at Docket No. I-860025.

This finding should be adopted *and strengthened* by a more vigorous defense of the capacity credit formula at 52 Pa. Order § 57.34(c).

2. *The reasonableness of the capacity credits in the instant proceedings is to be judged by a comparison to rates that would be required under West Penn's methodology, R.D. at 41-42.*

The only evidence regarding credits under Commission's regulations submitted in the instant proceeding was testimony by West Penn witness Kave. All parties are in basic agreement that West Penn's methodology is appropriate, although various "inputs" into the methodology were challenged. Therefore, as a practical matter, I believe that the ALJ's finding in this issue be adopted, with the *addition of express language* noting that West Penn's methodology results in lower capacity credits than an application of the Commission's regulations; therefore, since credits under the Commission's regulations would be *per se* reasonable, it follows that credits calculated under West Penn's methodology are *per se* reasonable as well.

3. *West Penn's avoided costs are to be determined as of the time that agreement in principle on rates was reached, which meets the definition of "serious negotiations", R.D. at 44-52.*

The Commission should adopt this portion of the R.D. as written, with the *addition of a caveat* that, if the evidence in this proceeding had demonstrated that West Penn had unreasonably delayed the issuance of project price proposals, the time frame of "serious negotiations" would

have been set as prior to the agreement in principle in rates. It is important that the Commission reiterate its position on time frame in a manner that prevents utilities from depriving QFs of avoided costs rate entitlement by delaying negotiations (see R.D. at 50).

4. *West Penn's projection that the next avoided unit would be a 300 MW base load coal unit, as opposed to a combustion turbine, was appropriate, R.D. at 71-80.*

The Commission should adopt this portion of the ALJ's R.D. with the *addition of language* at p. 80 *affirmatively stating* that the Commission agrees with West Penn that Allegheny Power System's (APS) load factor in conjunction with the volatility in the supply and price of natural gas and oil, the availability of economical sources of coal, and the public policy in Pennsylvania of encouraging the use of coal, supported West Penn's decision to add a coal unit as its next generating resource.

5. *Section 527 of the Public Utility Code does not mandate discounts from the full avoided cost standard of PURPA 210, R.D. at 95-97.*

The Commission should adopt the ALJ's R.D., with *language strengthening the conclusion.* Armco/Allegheny have in the past made superficially appealing but groundless arguments such as the Section 527 argument raised in this proceeding. I believe that strengthening this discussion is advisable.

6. *West Penn is directed to make a demand energy allocation of capacity charges as part of its next ECR filing, R.D. at 101-105.*

This rate structure issue is one that the Commission will have to address in the near future for all electric utilities that are flowing or that will begin to flow significant costs paid to QFs through the Energy Cost Rate (ECR) mechanism. The ECR mechanism allocates costs for fuel and purchased power strictly on an energy, or kwh, basis.

Whenever purchased power costs include payments for QF capacity, the ECR recovery mechanism is biased against high load factor, energy-intensive ratepayers (usually industrial ratepayers). If *utilities* build generating units and capital costs were recovered through *base rates,* costs would be allocated to customer classes on a demand/energy basis. Therefore, as utilities in the future begin to substitute purchases from independent power projects for their own construction, the rate structure issue takes on added importance. Ratepayers should remain indifferent to the source of supply as far as the allocation of costs is concerned. Thus far, arguments before the Commission in other ECR proceedings by industrial customers on this issue have received scant attention and met with little success. *See, e.g., Andrezeski v. Pennsylvania Electric Company,* Docket No. M-870172C001 *et seq.* (August 5, 1989) demand reallocation not appropriate at this time because demand component in Penelec's ECR is not large yet); *GPU Industrial Intervenors v. Metropolitan Edison Company* Docket No. M-870171C001 (August 15, 1989) (demand reallocation denied based on several factors and confusion regarding GPUII's proposals).

The ALJ's discussion up to the middle of page 104 should be adopted. However, the ALJ's statement at the beginning of the paragraph that the costs in question "will not be recovered through WPP's ECR until the next ECR proceeding" is in error. The costs in question will not be recovered for several years, after the projects are financed and constructed. Therefore, rather than ordering West Penn to make a demand/enegy allocation in the next ECR filing, I believe that the Bureau of Audits, with assistance from the Law Bureau, should be directed to prepare a recommendation for a future public meeting regarding the opening of a separate proceeding to address the rate structure issue. Depending on this recommendation, the Commission could issue a proposed regu-

lation applicable to all utilities *or* open a formal investigation into West Penn's ECR mechanism. Without input from Audits, I am unsure whether this issue should be handled generally or on a company-specific basis.

*Phase II*

A. *Milesburg*

The original financing date in Milesburg's contract of September 1, 1988 was extended to February 28, 1989 by a Consent Order signed by all parties and entered by the Commission on September 1, 1988. On February 8, 1989, Milesburg filed a Petition under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, requesting that (1) the financing date be extended to 120 days after a final and nonappealable Commission Order approving rate recovery, and (2) the capacity credit be increased from 3.3¢/kwh to 4.9¢/kwh to reflect the delay in the project's in-service date. Milesburg cannot go forward without an extension of the financing date, and avers that, since construction costs and interest rates have risen over time, the 3.3¢/kwh capacity credit can not longer support the project.

The ALJ recommended that Milesburg's Section 508 Petition be denied based on his finding that the contract between Milesburg and West Penn no longer exists due to the passing of the financing date. R.D. at 110-118. With respect to the request for an increase in the capacity credit, the ALJ found that the September 1, 1988 Consent Order specifically barred a capacity credit higher than that set forth in the contract. With respect to Milesburg's argument that the legally enforceable obligation of West Penn under PURPA 210 does not depend on the existence of a contract, the ALJ agrees, but states that "MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations*". R.D.

at 117 (emphasis in original). The ALJ concludes that, "[d]espite the obvious equities in favor of the MEI Project, the [contract] does not exist and cannot be approved." R.D. at 117. The ALJ recommends that West Penn's and Armco/Allegheny's petitions to withdraw/dismiss the Milesburg contract rate recovery petition be granted.

In my opinion, the ALJ's recommendation on these issues is in error, both legally and from a public policy perspective. First, regardless of whether or not the 1987 contract has lapsed, Milesburg is entitled to sell power to West Penn at rates based on West Penn's avoided cost projections in effect at the time of serious negotiations, as discussed above. Milesburg, which has been endeavoring to obtain a Commission Order approving rate recovery since April 1987, has done nothing to waive entitlement to these rates. The rates requested by Milesburg are rates calculated under West Penn's methodology, which (1) results in lower rates than the methodology in the Commisison's regulations and (2) is the appropriate methodology for determining avoided costs in this proceeding, as per the agreement of the parties and the ALJ recommendation. It therefore follows that if Milesburg is entitled to, for example, 6¢/kwh under the regulations, it is entitled to a *lesser* amount under West Penn's methodology. The fact that Milesburg has not attempted to invoke the capacity credit methodology in the Commission's regulations means that ratepayers will pay *less* for Milesburg power than would otherwise be required. Rather than require Milesburg to initiate a separate proceeding to seek *higher* rates, as the ALJ recommended, the Commission should require West Penn to execute a new contract with Milesburg, identical in most respects to the lapsed 1987 contract, with the financing date set six months after the receipt of a final and nonappealable Commission Order, with similar extensions to related milestones. It simply does not make sense to hold that Milesburg must initiate a new proceeding to seek rates

higher than the rates it has requested. Moreover, Milesburg already has been before the Commission and Commonwealth Court for 2½ years. In my opinion, requiring Milesburg to start over with a separate evidentiary proceeding likely would result in the abandonment of the Milesburg Project.

With respect to the rate determination, it is my opinion, first, that West Penn's methodology should be utilized, as modified by the additional calculation reflecting monthly, as opposed to annual, payments discussed above. This conforms with the ALJ's R.D. in Phase One at pp. 97-100. Very simply, West Penn "fine-tuned" its methodology between execution of the Milesburg contract and the other three contracts at issue in this proceeding. This refinement should be incorporated because the Commission would be ordering the execution of a *new* contract if this motion is adopted. Therefore, the newer format should be utilized. This refinement has the effect of lowering the rates paid to Milesburg.

Second, the "in-service date" of Milesburg (an input into West Penn's methodology) should be moved forward to 30 months after the receipt of a final, nonappealable Commission Order in this proceeding. Because we do not know if our Order will be appealed, or how long it will take to resolve any appeals that are filed, the particular capacity credit cannot be determined precisely at this time. However, *when* the projected in-service date is known, calculating the resulting credit is simply a mathematical exercise using West Penn's methodology.

This recommendation has the effect of increasing Milesburg's capacity credit because West Penn's methodology places a higher value on capacity that more closely matches West Penn's need for capacity in 1995. This is the reason, for example, that Shannopin's capacity credit of 4.0¢/kwh is higher than the other capacity credits at issue in this proceeding. The 30-month period after a final nonappealable Order is recommended (for estab-

lishing an in-service date) by deducting the six-month extension agreed upon by all parties to the Consent Order of September 1, 1988 from the estimated financing and construction period of 36 months.[1] Although the ALJ concluded that the Consent Order barred any increase to the capacity credit, in my opinion the Consent Order was intended merely to deny any increase based on the six-month extension that was agreed upon. In other words, a reasonable interpretation of the Consent Order is that the *quid pro quo* for getting parties to agree to the limited six-month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months.

In my opinion, it is essential that the Commission recognize and reflect regulatory delay in its Order. Project financing is very time sensitive because a project's capital costs are constantly increasing as time goes by. If a project is stuck with fixed rates as its costs go up, the project's internal rate of return will decline to the point that the project cannot be financed. Should the Commission fail to make adjustments for time delays, the Milesburg project likely will be abandoned. Perhaps more importantly, the Commission will be inviting interventions in opposition to future rate recovery proceedings because intervenors will know that they can win by default regardless of the merits of their position. In essence, intervenors will be able to kill future QF projects simply by filing answers in opposition to rate recovery petitions and taking the projects into a lengthy hearing and appellate process. This will be the exact result of the instant proceeding with respect to Milesburg if the Commission fails to make adjustments for regulatory delay, despite the clear findings of the ALJ (and presumably the Commis-

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[1] Milesburg estimated that construction would take 30-36 months; adding six months for financing to the lowest estimate for construction of 30 months equals 36 months.

sion) that the project is beneficial to ratepayers and to Pennsylvania and the equities are on the side of the QF.

Additionally, although the nominal capacity rate will increase, the rates in real terms will not increase as much due to the time value of the money and the delayed in-service dates. Secondly, the resulting capacity credit is merely the capacity credit that would have resulted from an application of West Penn's methodology *if* the parties could have anticipated the delayed in-service date resulting from the extensive litigation in this proceeding. West Penn's methodology is a conservative methodology for calculating avoided costs; hence the capacity credits calculated by the methodology likewise are low. Therefore, even with an adjustment to the in-service date, obtaining firm baseload capacity at a fixed rate of, for example, 5¢/kwh is a bargain compared to rates that would be paid for utility-built capacity.

For all of the foregoing reasons, the ALJ's recommendation regarding Milesburg in Phase Two of this case should be reversed.

B. *Burgettstown*

North Branch's April 5, 1989 Section 508 Petition similarly requests modification of milestone dates and increased capacity rates to reflect the delay in the in-service date for the Burgettstown Project. North Branch filed an Application for Stay on August 21, 1989 which was the subject of a 2-2 (no action) vote at the Public Meeting of August 31, 1989. On September 8, 1989, North Branch filed a Motion for Reconsideration and Amendment to its Exceptions to the ALJ's R.D. The Amendment withdraws North Branch's request for an increase to the capacity credit. Therefore, the Phase Two issues remaining before the Commission are:

1. The request to modify milestone dates set forth in the April 5 Section 508 petition.

2. The August 21 Application for Stay.

3. The September 8 Motion for Reconsideration.

The latter two issues, of course, post dated and therefore were not ruled upon by the ALJ's R.D.

For the reasons set forth in the previous discussion of Milesburg's Phase Two issues, I suggest that (1) the milestones be extended under Section 508; and (2) the Application for Stay of the financing closing date be granted. To do anything but to grant the stay and order the milestone extensions would make no sense, unless the Commission had decided to change its policy of encouraging the development of cogeneration and small power production. As North Branch states in its Motion for Reconsideration, failure to stay the financing closing date will result in automatic termination of its contract without any consideration of the merits, merely because of the length of time it has taken to complete this proceeding.

THEREFORE, I MOVE: That the Commission adopt an Opinion and Order consistent with all of the foregoing, modifying the Administrative Law Judge, Larry Gessoff's Recommended Decision regarding Phase I issues as discussed above and reverse the ALJ's Recommended Decision on Phase II issues, thereby granting extensions to Milestone dates for the Milesburg and Burgettstown Project and increasing the capacity rate for the Milesburg Project.

/s/ Bill Shane
BILL SHANE
Chairman

DATED: 9/20/89

Public Meeting of September 21, 1989

STATEMENT OF COMMISSIONER FRANK FISCHL

RE: WEST PENN POWER COMPANY PETITIONS
P-870216, P-880283, P-880284, P-880286
AUG-89-ALJ-124

I AM OPPOSED TO THE MOTION BECAUSE IT IS DETRIMENTAL TO WEST PENN RATEPAYERS AND IN SOME CASES BEYOND THE AUTHORITY OF THIS COMMISSION.

THE CAPACITY CREDITS REQUESTED ARE CLEARLY ABOVE WEST PENN POWERS' AVOIDED COSTS.

AS TO THE CONTRACT ISSUES, OUR REGULATIONS CLEARLY STATE NONINTERFERENCE WITH FREELY NEGOTIATED CONTRACTS. THE ALJ CORRECTLY CONCLUDED THAT IF THE DEVELOPERS ARE PERMITTED TO MODIFY THE NEGOTIATED ELECTRIC ENERGY PURCHASE AGREEMENTS BECAUSE OF UNFORESEEN EVENTS, THE CONTRACTS BECOME MEANINGLESS.

I; THEREFORE, VOTE *NO*.

September 21, 1989
DATE

/s/ Frank Fischl
FRANK FISCHL
Commissioner

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting September 21, 1989

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Docket No. P-879210, P-880283, P-880284, P-880286
ALJ—124

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF EEPA FOR MILESBURG *et al.*

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## STATEMENT OF COMMISSIONER JOSEPH RHODES, JR.

Mr. Chairman, I intend to support your motion for the resolution of the EEPA's of West Penn Power that are before us today, though I do so with considerable reluctance. In essence we are abrogating bona fide contracts that were willingly entered into by all parties. As anyone who has negotiated a contract would attest: a closing date is a crucial negotiated element of any contract. Time is money; and even more so when we are talking about electric utilities with long lead times associated with constructing generating facilities. What your motion does is to increase the certainty associated with PURPA projects for the developer and to decrease it for utilities.

What persuades me to support your motion is that the delays associated with these projects stem from extended litigation before Commonwealth Court and this Commission. I would, however, consider this action today to be the exception not the rule. "Once burned, shame on you; twice burned shame on me."

It would seem prudent that current and future QF project negotiations should anticipate the possibility that protracted litigation will delay the closing date for the project. Contracts should be sufficiently robust to take this into account. Of course, there is no free lunch. What I'm talking about is a kind of insurance with a schedule of power costs that reflect the slippage of time. Utilities should not have to provide this for free.

If such contingency provisions are not part of a QF contract and the closing date slides for any reason, this Commissioner will assume that the parties declined to take out the insurance policy and just got burned.

9-21-89
Date

/s/ Joseph Rhodes, Jr.
JOSEPH RHODES, JR.
Commissioner

**APPENDIX J**

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 21, 1989

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Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl, dissenting

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Docket Nos.
P-870216
P-880283
P-880284
P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASE POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

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## ORDER

BY THE COMMISSION:

Before us for consideration is the Recommended Decision ("R.D.") of Administrative Law Judge Larry Gesoff ("ALJ") issued June 27, 1989 in the above-

captioned consolidated proceedings, as well as the Exceptions and the Reply Exceptions filed by the various parties. Also before us is the Application for Stay of Proceedings and Motion for Reconsideration filed by North Branch Energy Partners, L.P. ("North Branch") on August 21, 1989 and September 12, 1989, respectively, at Docket No. P-880284, as well as various responsive pleadings thereto. For the reasons stated more fully below, we will (1) grant West Penn Power Company's ("West Penn") petition at Docket No. P-880283 for approval of the Electric Energy Purchase Agreement ("EEPA") with Noah Corp., the developer of the Monongahela Lock & Dam No. 8 Project; (2) grant West Penn's petition at Docket No. P-880286 for approval of the EEPA with Mon Valley Energy Corp. ("Mon Valley"), the developer of the Shannopin Mine Project; (3) grant West Penn's petition at Docket No. P-880284 for approval of the EEPA with North Branch, the developer of the Burgettstown Project, while granting North Branch's Petition for Modification and Application for Stay with respect to the Financing Closing Date and related milestones in its EEPA; and (4) require West Penn to execute a new EEPA with Milesburg Energy, Inc. ("Milesburg"), similar in terms and conditions to Milesburg's 1987 EEPA but with modifications to the Financing Closing Date and related milestones and revisions to the capacity credit, grant approval of the revised EEPA, and deny West Penn's petition to withdraw its rate recovery petition. With respect to the rate structure issue raised in this proceeding, we find merit in the concept of allocating capacity charges to customers on a demand/energy basis through West Penn's Energy Cost Rate ("ECR") mechanism. However, rather than requiring West Penn to modify its ECR in its next annual filing, we will open a separate proceeding to consider modifications to West Penn's ECR after receipt of an advisory report from our Bureau of Audits.

## BACKGROUND

The long history of these proceedings was fully described at pp. 1-32 of the ALJ's R.D., which we will incorporate by reference herein.

Following issuance of the ALJ's R.D. on June 27, 1989, Exceptions were filed by Milesburg, North Branch, the Office of Consumer Advocate ("OCA"), and Armco Advanced Materials Corp./Allegheny Ludlum Corp. ("Armco/Allegheny"). The West Penn Power Industrial Intervenor's ("WPPII")[1] filed a letter stating that it did not intend to file Exceptions to the ALJ's R.D. Reply Exceptions were filed by West Penn, OCA, WPPII, Armco/Allegheny and jointly by North Branch, Milesburg, and Mon Valley.

On August 21, 1989 North Branch filed an Application for Stay of Proceedings with respect to the Financing Closing Date of October 1, 1989 in its EEPA. West Penn filed an Answer and Armco/Allegheny filed a Protest opposing North Branch's Application on August 25 and August 28, respectively. On September 12, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for modification to its capacity rates, and a Motion for Reconsideration. Answers to the Motion for Reconsideration were filed by West Penn and Armco/Allegheny on September 15 and September 13, respectively. North Branch filed a Response to West Penn's Answer on September 19, 1989.

Our decision of today's date addresses the merits of the issues raised in these consolidating proceedings and grants North Branch's Application for Stay.

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[1] WPPII is an ad hoc group of industrial customers comprised, in these proceedings, of Airco Industrial Gases, Latrobe Steel Co., National Roll Co., Pennsylvania Pressed Metals, Powder Metal Products, Inc., and PPG Industries, Inc.

## DISCUSSION

We will address the issues raised in this proceeding seriatim by reference to the ALJ's R.D. regarding each issue, which we incorporate by reference herein, and the Exceptions and Rely Exceptions thereto. A discussion and ruling on the North Branch Application for Stay will follow. Phase I of the proceeding generally addresses the reasonableness of the capacity credits set forth in the various EEPAs as well as the rate structure issue regarding the methodology by which the capacity costs paid by West Penn to developers of qualifying facilities ("QFs") should be recovered from ratepayers. Phase II of the proceeding addresses issues raised by the lengthy delay in the approval process to which the EEPAs have been subjected.

### A. PHASE I.

#### 1. *The Legal Standard to be Applied; R.D. 32-42.*

The ALJ rejected the arguments of Armco/Allegheny and OCA that the Commission's regulations cannot be used as a benchmark to assess the reasonableness of capacity rates in negotiated contracts. Rather, the ALJ concluded that, if negotiated rates are at or below the rates to which a QF would be entitled as a matter of law (i.e., as defined by the Commission's regulations), the rates are *per se* reasonable. The ALJ rejected the collateral attack by Armco/Allegheny and OCA on the Commission's regulations, stating that they are in full force and effect unless and until they are modified by the Commission or invalidated by the Commonwealth Court. Nevertheless, the ALJ concluded that, due to the nature of the evidence in this record, in these proceedings the reasonableness of the various capacity credits should be measured against West Penn's methodology as opposed to the Commission's regulations.

Milesburg excepts to the ALJ's conclusion that, due to the evidence in this record, the Commission's regulations

cannot be used as the benchmark in these proceedings. Milesburg states that West Penn's witness introduced the calculations under the regulations into the record on behalf of the parties to this proceeding, and that whether West Penn or other parties are critical of the regulations is irrelevant. Milesburg notes that the Commission consistently has held that its regulations should serve as the standard against which the reasonableness of rates in an EEPA are to be evaluated.

North Branch excepts to this portion of the ALJ's R.D. as well, noting that West Penn's witness stated on the record that West Penn's avoided cost filing of July 31, 1986, which reflected a capacity credit for 1991 of 4.85 cents per kwh, represented West Penn's best estimate of its avoided costs based on its interpretation of the regulations. North Branch states that the ALJ erred in disregarding the calculations based on West Penn's opposition to and collateral attack of the regulations.

OCA excepts to the portion of the R.D. that states that calculations under the Commission's regulations could serve as a proper benchmark against which the reasonableness of the capacity credits could be measured based on OCA's argument that the Commission's regulations do not employ discounting and therefore violate Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S. § 824a-3 ("PURPA 210").

West Penn's Reply Exceptions at p. 2 state that "[n]o party has challenged the formulas developed by [West Penn] for computing avoided cost, which produce a lower avoided cost figure than under the Commission's own regulations, but rather only the inputs used in the formulas." West Penn states that it is not necessary in this case to choose between West Penn's and the Commission's methodologies because, except for a minor adjustment to the Milesburg calculation, use of either methodology results in approval of the contract rates as being at or below avoided costs.

North Branch, Milesburg and Mon Valley, jointly filed Reply Exceptions ("Projects' Reply Exceptions") stating that OCA's criticism of the Commission's regulations should be given no consideration in these proceedings.

OCA's Reply Exceptions state, *inter alia,* that the ALJ's recommendation not to apply the Commission's regulations was not based on West Penn's criticisms, but on the lack of an adequate evidentiary foundation for their consideration. OCA states that the Projects had an opportunity to file answering testimony and alternate calculations. OCA argues that the testimony of West Penn witness Kave and West Penn's 1986 avoided cost filing were not sufficient evidence.

Armco/Allegheny's Reply Exceptions state that, since the R.D. assessed the various capacity credits based on West Penn's methodology, it makes no difference that the R.D. did not compare the capacity credits to rates derived under the Commission's regulations. Armco/Allegheny argue that the regulations are ambiguous and produce rates in excess of avoided costs; that West Penn's avoided cost filings apply only to QFs of 500 kw or less; and that the QFs in this proceeding are not automatically entitled to capacity rates set forth in annual avoided cost filings.

On this issue, we adopt the ALJ's recommendation. The reasonableness of rates in negotiated contracts generally is to be determined by a comparison to rates that would be required by an application of the Commission's regulations. This is a fundamental concept that has been the basis for nearly all of the Commission's Orders approving rate recovery of amounts to be paid to QFs under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the generic investigation at Docket No. I-860025 or otherwise. We find no merit in arguments that our regulations overstate a utility's avoided costs. State regulatory com-

missions have been granted a substantial degree of latitude in the implementation of PURPA 210, and avoided costs are *defined* by our regulations. In other words, our regulations determine what a utility's avoided costs are under the law, notwithstanding arguments that a different methodology or methodologies might be preferable. The possibility that our regulations may not be perfect in some party's view is irrelevant. The regulations were finalized in January 1983 after an extended notice and comment period in a proceeding where all interested parties had the opportunity to make their views known. Although we may refine our regulations as a result of our generic investigation, in our view the regulations are basically sound. In particular, our coal proxy regulation at 52 Pa. Code § 57.34(c) recognizes the fact that logically the next base load unit for a utility in Pennsylvania that is anticipating a need for additional base load capacity would be a coal plant. By basing capacity credits on a capital-intensive unit with relatively stable associated energy credits, the coal proxy regulation encourages the development of capital-intensive qualifying facilities such as those that are fueled by coal or coal waste. From both a ratepayer and a public policy perspective, in our view it is important that our regulations under PURPA 210 permit continued development of coal and coal waste facilities.

Nothwithstanding the fact that generally avoided costs are to be determined by application of our regulations, we agree with West Penn that it is not necessary in this proceeding to choose between West Penn's and the Commission's methodologies because use of either methodology results in approval of the contract rates. All parties agree that West Penn's methodology produces rates that are lower than rates produced by the Commission's regulations. None of the Projects have requested rates calculated under the regulations. Therefore, as a practical matter, we adopt the ALJ's recommendation to utilize West Penn's methodology as the benchmark for determin-

ing West Penn's avoided costs in these proceedings. Since rates calculated under our regulations would be *per se* reasonable, and West Penn's methodology produces lower rates, it follows that rates calculated under West Penn's methodology (assuming the inputs are appropriate) are *per se* reasonable as well. Our decision on this issue also renders it unnecessary to resolve any ambiguities that may exist in our regulations at this time.

2. *Burden of Proof, R.D. at 42-44.*

The ALJ concluded that under Section 332(a) of the Public Utility Code, 66 Pa. C.S. § 332(a), West Penn has the burden of proof in these proceedings as the proponent of an Order. The ALJ states that West Penn must meet its burden of proof by substantial evidence. No party filed an exception to this conclusion. We adopt the ALJ's recommendation on this issue.

3. *Time Frame, R.D. at 44-52.*

With respect to the time frame that will be utilized to determine West Penn's avoided costs, the ALJ recommended adoption of West Penn's agreement in principal on rates as the time of serious negotiations under the Commission's standard set forth in *Pennsylvania Public Utility Commission v. Duquesne Light Company*, Docket No. R-860556 (July —, 1987). Agreement in principle on rates was reached in April 1985, May 1986, September 1986, and October 1986 for the Monongahela, Milesburg, Shannopin and Burgettstown Projects, respectively.

The only party to file an exception to this recommendation was Armco/Allegheny, which argue that the date that the EEPAs were executed should be utilized. Armco/Allegheny state that two tax changes occurred prior to the contract signing dates that should be incorporated into the calculation of the capacity credits for the Milesburg, Shannopin and Burgettstown Projects, namely the Tax Reform Act of 1986, signed into law October 22, 1986

and effective in tax years 1987 and beyond, and a reduction in the Pennsylvania Corporate Net Income Tax effective January 1, 1987. Armco/Allegheny argue that the dates of contract execution (February 25, 1987 and October 15, 1987) are the earliest dates that the serious negotiations standard should be deemed satisfied because these were the dates the Projects were legally committed.

West Penn's Reply Exceptions state that the issue is whether West Penn's use of time of agreement in principle to determine avoided costs was reasonable. West Penn notes that Armco/Allegheny offered no witness with experience in negotiating QF contracts or with experience in financing such contracts; witnesses with such experience were West Penn's chief contract negotiator; representative of the Projects, and a Vice-President of Mellon Bank with considerable experience in project financing. West Penn states that the testimony of these witnesses demonstrates that calculation of avoided costs at the time of agreement in principle on rates is critical to encourage and stabilize the process of voluntary negotiation of contracts under PURPA, since the developer of a QF needs rates upon which it can rely in evaluating the potential feasibility of a project. Typically, a developer has only limited available resources and has to borrow between 75% and 85%, and sometimes more, of the funds necessary to construct a facility. Usually this money is loaned without recourse to any assets other than the project itself; therefore, lending institutions must rely on the revenue stream generated by the sales of power to repay the debt. As a result, substantive evaluation of project financing cannot be made until the qualifying facility and the utility have agreed upon a particular rate. An up-front evaluation of economic feasibility is important because often the substantial investment to lay the groundwork for a project is not possible without some assurance that the project is economically feasible. If West Penn were not able to agree to purchase rates until a contract is

signed, the QF could get all the way to final contract negotiations only to find the avoided costs for capacity have dropped. West Penn states that, although a broad "serious negotiation" standard creates problems for a utility, West Penn's selection of a specific point during negotiations (agreement in principle) is consistent with the intent of the serious negotiation standard. In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. West Penn states that Armo/Allegheny's argument on this point applies hindsight because, in this case, lower rates would result. However, avoided costs just as easily could have increased.

The Projects' Reply Exceptions state that Armco/Allegheny's position on the tax issue in reality is a request that the Commission change its policy on the serious negotiations standard, and that any changes in policy should not be made retroactively. Acceptance of Armco/Allegheny's argument would assume that existing policy is meant to be changed on a case-by-case basis and would seriously undermine the Commission's credibility. The Projects support the Commission's standard because it ensures that negotiated rates will be preserved as negotiations continue; under Armco/Allegheny's proposal developers would be required to petition the Commission for higher rates under the regulations in order to "lock-in" avoided cost estimates. The Projects note that Armco/Allegheny relied solely on the testimony of one witness to support their argument who had no experience in advising parties to QF contracts, had never negotiated a QF contract, and did not consider the effect of his theory on potential developers. Nevertheless, with no experience or background, the witness stated that "[t]he time frame of serious negotiations is completely nebulous and ambiguous. Such a time frame could expanse years of negotiations prior to the signing of a contract." Projects' Reply Exceptions, p. 3. The Projects assert the time frame for

serious negotiations is neither nebulous nor ambiguous, and that each project has identified a specific period, none longer than seven months, during which rates were agreed upon and expenditures were made in reliance thereon. The Projects state that Armco/Allegheny's witness has confused negotiation of rates with negotiation of technical terms and conditions. The Projects refer to testimony that, without a firm commitment on price (1) contractors and engineers are reluctant to provide bids and financing is unavailable; (2) developers would not risk the substantial development costs required to perform essential activities necessary to advance a project from the early feasibility study stage to contract signing; and (3) use of contract execution date would have a chilling effect on cogeneration and small power production. The Projects state that use of hindsight would establish a constantly moving target with respect to avoided capacity rates and could be used by a utility to circumvent the requirement to provide capacity credits to a QF merely by refusing to enter into an EEPA or by delaying execution of an EEPA. The Projects argue that the rates quoted to the Projects were reasonable at the time, and any change thereto would be retroactive policy-making which has never been contemplated by this Commission even in the generic investigation. Finally, the Projects' Reply Exceptions briefly describe the negotiations and project development work that took place for each Project and conclude that each Project satisfied the serious negotiations standard in *Duquesne*. The Projects aver that Armco/Allegheny's proposal is totally unrealstic and cannot result in a negotiated EEPA because an EEPA cannot be executed without the prior completion of substantial development work. With respect to the related tax issue, the Projects state that West Penn correctly applied the tax laws in effect at the time of serious negotiations in the calculation of the Fixed Charge Rate ("FCR"). The Projects' rates were calculated in or before May 1986 while the Conference Report on the Tax Reform Act of

1986 was not issued until September 19, 1986. Thus, it is unreasonable to argue that West Penn should have recalculated its prior firm price quotes after the Projects had expended substantial amounts of money in reliance upon those rates.

On this issue we adopt the ALJ's recommendation, and reiterate our longstanding policy that avoided costs are to be determined as of the time of serious negotiations. Objective criteria are needed and must be applied consistently to give reliability to negotiations between utilities and QFs. Otherwise, avoided cost rates would evolve into a constantly moving target, a phenomenon that would undermine contract negotiations and chill the continued development of cogeneration and small power production facilities. Our policy was formulated in recognition of the fact that a utility's avoided costs could drop; however, a utility's avoided costs just as easily could rise. The ALJ correctly noted that, "[u]ltimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up." R.D. at 51. For the reasons set forth in the Reply Exceptions of West Penn and the Projects, we find that Armco/Allegheny's argument that time of contract execution should control is without merit. Therefore, we affirm our policy on the serious negotiations standard and accept West Penn's agreement in principle on rates as the time that the serious negotiations standard was satisfied. Our adoption of the agreement in principle on rates is limited to the facts of the instant proceeding since utilities other than West Penn utilize different practices and procedures when negotiating QF contracts. Moreover, if the evidence in a proceeding demonstrated that a utility unreasonably delayed the issuance of project price proposals, the time frame for serious negotiations would be set prior to the agreement in principle on rates. In addition to the need to prevent avoided costs from evolving into a moving target,

there is a need to assure that utilities cannot deprive QFs of avoided cost rate entitlement by delaying negotiations.

4. *The Reasonableness of the Capacity Rates in the EEPAs.*

a. *West Penn's Methodology, R.D. at 52-55.*

The ALJ's description of West Penn's methodology is not a recommendation on a contested issue, and does not require a discussion. Nevertheless, the ALJ's R.D. aptly summarizes West Penn's methodology and the remaining issues in Phase I of these proceedings. Therefore, for purposes of clarity and completeness, we will set forth in full this section of the R.D.

West Penn's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. West Penn's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. West Penn's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, shows that new, avoidable generating capacity

would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of West Penn's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problebs. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlyling information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under

dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, West Penn maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged West Penn's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs West Penn used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that West Penn's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, Armco/Allegheny and WPPII argue for EEPA capacity rates to be passed through to West Penn's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

b. *Reserve Margin, R.D. at 55-71.*

The ALJ recommended adoption of West Penn's planning reserve margin of 25%. Armco/Allegheny and OCA argued for reserve margins of 15% and 20%, respectively. The ALJ's R.D. accurately summarizes the position of each party and is, as stated above, fully incorporated herein by reference. The ALJ concluded that West Penn demonstrated that its planning reserve margin was not out of line with the electric industry throughout the United States and within the North American Reliability Coun-

cil's ("NERC") regional council; that West Penn's high load factors and number of super-critical generating units supported its 25% margin; that West Penn used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability; and that West Penn used correct judgment in considering potential acid rain legislation as one of several reasons why current availability data might not hold in the future. The ALJ concluded by noting that forecasting a reserve margain requires the use of studies and computer analyses, but the final decision requires informed judgment based on experience. The ALJ found that West Penn demonstrated that its 25% reserve margin decision was supported by studies available when the decision was made and by informed judgment based on experience, and recommended approval of the 25% planning reserve margin.

OCA and Armco/Allegheny excepted to the recommendation. OCA reiterates its claim that Allegheny Power Systems ("APS"), West Penn's parent company, should have conducted new reserve margin and generation planning studies in 1986, which would have indicated that the planning reserve margin should have been no more than 20% based primarily on an increase in unit availability on the APS system between 1983 and 1986 and OCA's view that large interconnected systems generally have a reserve margin of 15% to 20%. Armco/Allegheny reiterate their claim that West Penn did not meet its burden of proof with respect to its 25% planning reserve margin because the studies relied upon by West Penn were outdated and because West Penn and APS have allowed their reserve margins to drop below 25% by entering into agreements for the sale of 700 MW to out-of-state utilities.

West Penn's Reply Exceptions state that the issue is not, as OCA and Armco/Allegheny would like frame it, whether APS should have done a formal study in 1986 but whether, in light of the objective information avail-

able to APS planners in 1986, the judgment to use a 25% planning reserve margin in calculating avoided costs for these contracts was reasonable. West Penn states that the ALJ correctly concluded that its judgment regarding the proper planning reserve margin was appropriate given, *inter alia*, the existence of the super-critical units on the APS system, APS' high load factor, and the availability of the units. With respect to Armco/Allegheny's exception, West Penn states that the 700 MW off-system sale in the winter of 1988/89 has no bearing on APS' planning reserve margin because the sale is interruptible and subordinate to native system load, which permits APS to use its existing capacity effectively without compromising system reliability. APS does not plan for off-system sales when determining that new capacity is needed; therefore the projected addition of capacity in 1995 was planned to meet native load plus a 25% reserve margin, as opposed to native load, plus off-system sales, plus 25%. West Penn notes that the 700 MW off-system sale actually was a sale of 700 MW for one year dropping to 300 MW for six years and zero thereafter.

The Projects' Reply Exceptions emphasize that West Penn's 25% planning reserve margin had been sanctioned by the Commission in two prior proceedings, that the reserve margin is being used for planning purposes by West Penn to this day, and that West Penn still projects a need for energy in 1995. The Projects state that the reasonableness of West Penn's planning reserve margin is the issue, not the exact results of West Penn's forecasts.

Upon review of the Exceptions and Reply Exceptions we find nothing that was not considered by the ALJ prior to making his recommendation that West Penn's planning reserve margin of 25% be adopted. The ALJ's decision on this issue is persuasive and we adopt it as our own. We find particularly persuasive the rebuttal testimony of West Penn's Director of Planning regarding the factors

that were taken into account in establishing the reserve criterion, particularly the existence of ten super-critical units ranging in size from 540 mw to 640 mw, each of which is about 10% of the APS system peak load; APS' high load factor, which is normally one of the ten highest load factors of the top 100 investor-owned utilities in the country; and the uncertainty whether the recent improvement in unit availability would continue given, *inter alia*, the fact that the equipment is aging and the temporary lower stress levels on individual units resulting from temporarily higher operating reserves. One issue raised on exception that was not addressed by the R.D. was Armco/Allegheny's argument that the *interruptible* off-system sale of 700 MW in 1988/89 (dropping to 300 MW for six years) demonstrated that West Penn did not need additional capacity. We find this completely unpersuasive for the reasons set forth in West Penn's Reply Exceptions.

c. *Coal Unit v. Combustion Turbine, R.D. at 71-80.*

The capacity credits in this proceeding were based on West Penn's projection in 1986 that the next generating unit it would construct would be a series of three 300 MW coal units, the first of which would be brought on line in 1995. OCA argued that in 1986 West Penn should have planned to construct oil or gas fired combustion turbines ("CTs") to provide peaking capacity before constructing additional coal units. The ALJ concluded that West Penn submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in 1995.

OCA excepted to this finding, arguing that peaking units (oil or gas fired CTs) should have been planned by West Penn rather than base load generation in the form of coal fired units. OCA's preference for oil or gas fired units is based on arguments pertaining to need for fuel

diversity, projected fuel costs for the coal plant v. marginal fuel costs on the system, and the use of a dependent forced outage rather than actual unit unavailability in West Penn's studies.

West Penn's Reply Exceptions state that the APS 1986 Generation Plan was supported by considered judgment based on the following factors:

(1) the many years of satisfactory service provided by coal-fired units to APS and its ratepayers;

(2) the drastic escalation in the price of oil and gas even though tempered by a drop in prices in late 1985 and early 1986;

(3) the results of studies that at best showed only a minor financial advantage for combustion turbines;

(4) the technological limitation(s) on combustion turbines at that time; and

(5) public policies and laws designed to encourage the use of coal.

West Penn's Reply Exceptions refer to its Main Brief and Reply Brief, which refute the arguments in support of an oil or gas fired peaking unit raised by OCA. With respect to fuel diversity, West Penn states that the objective is not to provide a pre-determined fuel mix, but to provide a reliable power supply at the lowest cost, which should be done by using the fuel sources that are the most reliable and cost the least over the planning horizon. West Penn notes that the APS service area has large reserves of coal that have over time provided a stable supply of fuel at a reasonable cost; that the availability and price of oil and gas have been unpredictable and uncertain; and that the economy of the APS service area benefits from the use of coal.

With respect to OCA's argument comparing fuel costs of a coal plant to the fuel costs of the APS system, West

Penn states that even if the new coal units were projected to have a higher operating cost than the average costs on the system, it is inappropriate to compare operating costs between types of generation. West Penn notes that if this type of comparison were to be made, CTs always would have exceedingly high costs (about 4¢ to 10¢/kwh depending on oil and gas prices) compared to coal. West Penn states that neither of the computer runs discussed by OCA shows either a large benefit or cost to installing CTs, and that there certainly was not enough difference to make a decision based *only* on computer runs. West Penn avers that "[t]he decision to stay with coal fired generation was based on the experience of many years and common sense. *The use of coal has been the reason the APS cost of electricity has been among the lowest in the country.*" West Penn Reply Brief at 12 (emphasis supplied).

With respect to OCA's argument on the use of dependent forced outage rates, West Penn states that the purpose of using these rates is to better model the way the power system actually operates. While most computer models use an average forced outage rate, in actual practice many units may be out of service at one time, necessitating the use of CTs. West Penn states that if there are many units out of service at the same time, usually it is due to some type of dependency, i.e., weather-related, equipment similarities, storms, etc. When these dependent forced outage conditions do occur, necessitating the use of CTs, it might be necessary to run them eight to thirteen hours a day because of the APS high daily load factors, where hourly loads do not vary much over long periods during the day.

The Projects' Reply Exceptions state that OCA's entire argument that the avoided unit should have been a CT rather than a coal-fired unit is that planning and judgment cannot be used along with a least cost study. The Projects state that, while all of West Penn's planning

for the mid-1990's included adding base load plant in 1995, OCA unilaterally decided that West Penn should add peaking power in that year and assumed a low cost and available source of oil in 1995 and beyond. The Projects state that none of OCA's assumptions as to oil prices were known in early 1986, and that OCA's continued reliance on its argument with respect to cheap and stable oil prices in the future is unsupportable in light of the current state of the fuel market. Finally, the Projects note that West Penn added considerable peaking capacity in 1986 (the Bath County Pumped Storage Unit), and that there is nothing on the record to support the proposition that another large peaking unit is needed next.

We agree with the ALJ's recommendation on this issue; further we find compelling reasons supporting West Penn's choice of a coal-fired base load unit as opposed to an oil or gas-fired CT as the next generating plant on the system. Even assuming for the purposes of argument that studies showed a financial advantage to CTs, the advantage was minor at best. West Penn appropriately used its experience and judgment as well as formal studies when formulating its capacity addition plans. Its experience supported the choice of a coal unit for many reasons, including the many years of satisfactory service of coal units to its ratepayers, and the fact that the reason West Penn's rates are the lowest in Pennsylvania and among the lowest in the country is due to the use of coal. The volatility in the supply and price of natural gas and oil as well as the public policy in Pennsylvania of encouraging the use of coal also supported its decision. Additionally, West Penn's high daily load factor supports the decision to add additional base load capacity, as opposed to oil or gas fired peaking units (with low capital costs but high fuel costs), as well as the use of dependent forced outage rates in its studies. In sum, we strongly endorse West Penn's decision to add a coal-fired unit as opposed to an oil or gas-fired CT as its next generating unit. Selection of a CT over a coal unit due to at best a

minor financial advantage produced by a formal study in our opinion would have been unwise. First, it would have exposed ratepayers to the volatility in the supply and price of oil and gas in the future; whereas coal supplies in the APS service territory are abundant and can be procured under long term contract. Second, in our opinion West Penn gave appropriate consideration to the public policy in Pennsylvania of encouraging the use of our indigenous coal resources and the economic benefits in the service territory resulting from the use of coal. The choice of a coal unit over a CT has more than theoretical consequences for the Projects under consideration, even though the Projects are designed to avoid or defer the construction of the next unit by APS. The Projects are themselves capital-intensive as they are designed to utilize coal and coal waste. Generally speaking, a capital-intensive project cannot be supported by capacity credits derived from a low cost combustion turbine. Moreover, we note that OCA did not advocate revising the Projects' *energy* credits (which were not challenged by any party to these proceedings) to reflect the fact that its avoided unit of choice would be fired by oil or gas as opposed to coal. It is an interesting position that advocates capacity rates based on a cheap oil- or gas-fired combustion turbine and energy credits based on coal.

There is an independent reason why basing the capacity credits in this proceeding on a coal plant was required that was not addressed by the ALJ's R.D. As West Penn notes in its Reply Brief, in 1986 it was anticipating inadequate system reliability within the next ten years as a result of not being committed to sufficient plant because its reliability criterion of a 25% reserve margin would not be met without additional generating units. Under 52 Pa. Code § 57.34(c)(4)(iii) this triggers the required use of a coal plant as a proxy. Therefore, in addition to the fact that West Penn reasonably selected a coal plant as its next generating unit, our regulations would have required the payment by West Penn

of capacity credits based on a coal plant even if West Penn had not selected any particular type of generating unit at all.

For all of the foregoing reasons, we find that the capacity credits in this proceeding should be based on the costs of a coal-fired generating unit.

d. *Mitchell and Springdale Units, R.D. at 81-85.*

In 1983 West Penn's Springdale and Mitchell generating units were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the Springdale and Mitchell units, collectively 361 MW, would not be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. WPPII argued that West Penn could return the units to active service by expending $71 million, and that West Penn's capacity credits should have been based on the reactivation costs rather than a new 300 MW coal unit. West Penn responded by noting that its 1986 Generating Capacity Plan showed the need for additional capacity in 1995 *despite* the planned reactivation of Springdale and Mitchell in 1992 and 1993. West Penn also noted that Mitchell and Springdale are oil-fired peaking units, and the Commission's regulations base capacity credits on a peaking unit only when it is due on-line within five years. Since in 1986 Springdale and Mitchell were not "committed" units under the regulations, they were properly not used as the basis of the capacity credits in West Penn's avoided costs calculations.

The ALJ agreed with West Penn's application of the facts to the Commission's regulations at 52 Pa. Code § 57.34(c)(4)(i) and (iii), while disagreeing with West Penn's conclusion that the regulations require the use of costs associated with a new plant, as opposed to one in cold reserve. The ALJ rejected Armco/Allegheny's argument that the capacity credits in these proceedings should

be based on the costs of reactivating Springdale and Mitchell.

No exceptions to the ALJ's recommendation on this issue were filed. We agree with the ALJ and find that the costs of reactivating Springdale and Mitchell were not the proper basis for determining West Penn's avoided costs in these proceedings. West Penn's Generating Capacity Plans in 1986 showed West Penn's need for a 300 MW coal unit in 1995 *in addition to* the planned reactivation of Springdale and Mitchell in 1992 and 1993.

Where a utility projects a need for more than one capacity addition, nothing in our regulations bars the payment of capacity credits based on more than one plant. Therefore, although it was appropriate for West Penn to offer the projects in these proceedings capacity credits based on its 1995 coal plant, West Penn also could have offered capacity credits to other QFs based on the reactivation of Springdale/Mitchell in 1987-1988 (five years before the planned reactivation). Although the resulting capacity credit would have been extremely small, the energy credit associated with Springdale and Mitchell, which are oil-fired, would have been substantially higher than the energy credits at issue in these proceedings. In sum, just as utility capacity addition plans are not mutually exclusive, capacity credits based on different capacity addition plans likewise are not mutually exclusive. In 1986 the appropriate plant upon which West Penn's avoided costs were based was the 1995 coal plant; even if West Penn had planned to reactivate Springdale and Mitchell within five years or by 1991, the Projects in question would have had the choice of which capacity addition plan they would help defer or avoid, which would in turn determine their appropriate avoided costs.

e. *Fixed Charge Rate, R.D. at 85-95.*

West Penn utilizes a levelized annual fixed charge rate ("FCR") to estimate the cost of owning capital assets. The principal elements of the FCR are the cost of capi-

tal, depreciation, income taxes, insurance, and property related taxes. West Penn used a FCR of 17.7% for all three contested Projects. Armco/Allegheny argued for a FCR of 13.88% for Milesburg and 14.65% for Burgettstown and Shannopin. The ALJ concluded that West Penn calculated its FCR correctly and recommended its acceptance.

No exceptions were filed with respect to the ALJ's findings on cost of capital, capital structure, cost of debt, cost of preferred stock, state and federal taxes, ad valorem rate (insurance and property taxes), or rate base. We adopt the ALJ's recommendation on these issues as our own.

Armco/Allegheny excepted to the ALJ's recommendation to adopt West Penn's forecasted return on equity of 15%. West Penn's forecast was made by adding a risk premium of 400 basis points to forecasted bond rates, since it is universally recognized that investments in common stock are riskier than investments in bonds. To encourage investment in common stock, it is necessary to provide a higher return than an investor could receive in the bond market.

Armco/Allegheny argue that the most appropriate return on equity would be the return of 14.25% approved by the Commission in July 1986 in West Penn's Bath County rate proceeding at Docket No. R-850220. Armco/Allegheny argue that only the Commission can set a utility's return on equity, and that West Penn, unlawfully usurped the Commission's authority by forecasting a higher rate of return. Armco/Allegheny state that West Penn committed its ratepayers to pay a higher return on equity to the QF developers than the Commission had required West Penn's ratepayers to pay to the utility.

West Penn's Reply Exceptions note that the return on equity in the FCR for these avoided cost calculations required economic forecasting for the life of the contracts, *i.e.*, as far out as the year 2031 (33 years past 1998). Armco/Allegheny did not contest the reasonableness of

West Penn's projections; rather, Armco/Allegheny contended that using *any* projection was an error of law. West Penn states that Armco/Allegheny's argument defies logic and erroneously assumes that West Penn's return on equity is static and will remain at 14.25% for over 33 years. The Projects' Reply Exceptions note that Armco/Allegheny did not argue that West Penn's forecast was incorrect, and that the rates for each of these Projects were first quoted to developers prior to July 24, 1986, when the return on common equity from the then prior rate case was 15.5%.

Armco/Allegheny's argument on this point requires little discussion. We agree with West Penn that it defies logic to assume that West Penn's rate of return on equity will remain static for the next 30-40 plus years. All components of an avoided cost calculation, including a fixed charge rate, require the use of reasonable projections. The use of a forecasted 15% return on equity did not usurp a Commission function. Therefore, we adopt the ALJ's recommendation on this issue.

f. *Availability Factor.*

Armco/Allegheny have excepted to the fact that, through an oversight, the ALJ's R.D. failed to rule on their argument that the availability factor of the avoided coal unit should have been 80% rather than 75%. The availability factor is the percentage of time during the year that the avoided unit would be expected to operate, and is used as a component in the calculation of West Penn's capacity credit. The lower the assumed availability factor, the higher the capacity credit because the cost of the avoided unit will be spread over fewer Kwh. Armco/Allegheny aver that the newest scrubbed coal-fired units on the APS system are the 621 MW Pleasants Units, which had average availabilities of 80-81% between 1983-1987. Armco/Allegheny aver that, although the only other scrubbed coal-fired unit on the APS system, Mitchell No. 3, had an availability of only 73.9% between 1983-1987, it is more appropriate to use the Pleasants Units

because they are newer and provide a better indication of the expected availability of units that would be built in the mid-1990s.

West Penn's Reply Exceptions state that Armco/Allegheny selectively analyzed APS availability data in order to find an example to support its contention. West Penn takes into account many factors, including potential acid rain legislation, in forecasting future availability. Selections of one four year average availability of one unit does not support an assumption that West Penn should anticipate that particular availability over the economic life of the avoided unit. The Projects' Reply Exceptions similarly state that the selection of only *one* time period for *one* unit does not support use of the corresponding availability factor.

On this issue we agree with West Penn, and reject the argument of Armco/Allegheny. Selection of one four year period for one unit does not support an assumption that the avoided unit would have had an equivalent availability factor over its useful life. Even if the Pleasants Units were selected as the best representative *units* on the APS system, the four year *period* of 1983-1987 selected by Armco/Alleheny occurred very soon after Pleasants Units 1 and 2 were placed in-service in 1979-1980. It is unreasonable to assume that a plant will continue to operate over its 30-33 year life at the same availability factor that it did when it was nearly new. Over time, equipment ages and must be replaced. Therefore, we find that the four year availability factor cited by Armco/Allegheny is not particularly relevant, and adopt West Penn's projection of a 75% availability factor for the life of the avoided unit.

5. *Section 527 of the Code, R.D. at 95-97.*

The ALJ's R.D. rejected Armco/Allegheny's argument that Section 527 of the Public Utility Code, 66 Pa.C.S. § 527, requires discounts from full avoided costs. We

rejected this argument previously in our Order on Reconsideration in these proceedings entered January 19, 1989. Nevertheless, Armco/Allegheny argue that Section 527 applies to negotiated rates as opposed to rates set administratively by the Commisison.

The ALJ rejected Armco/Allegheny's argument as "engaging in legislative mindreading with no support except stretched logic." R.D. at 97. The ALJ concluded that, since Section 527 cannot be used against full avoided cost rates calculated under the Commission's regulations, neither can it be applied to full avoided cost rates in a voluntary agreement. The ALJ notes that, even though not mandated by Section 527, the record in these proceedings demonstrates that the EEPA rates are below West Penn's avoided costs.

Armco/Allegheny's Exceptions at p. 32 repeat their assertion that "Section 527 clearly requires that in Pennsylvania rates paid to QFs should be *less than* avoided costs since this is the only way to provide ratepayers with savings as a result of cogeneration." (emphasis supplied). While conceding that the federal full avoided cost standard applies to rates imposed by the Commission as a result of a complaint proceeding, Armco/Allegheny assert that PURPA does not apply to a negotiated contract. Armco/Allegheny also argue that none of the contracts under consideration provide for savings since West Penn's input assumptions into its methodology were erroneous, and that even if the inputs were correct, the savings under the contracts are not enough.

West Penn's Reply Exceptions state that Section 527 is clear on its face and, rather than mandating discounts from avoided costs, requires only that discounts that do exist be passed on to ratepayers. West Penn states that there is no legislative history to support Armco/Allegheny's interpretation of Section 527, and that any requirement that rates available to QFs in voluntary contracts be below avoided costs would be preempted by federal law.

The Projects' Reply Exceptions characterize Armco/Allegheny's argument on this issue as farfetched, and note that the Federal Energy Regulatory Commission ("FERC") directly addressed the savings issue and mandated that rates to QFs be set at a utility's *full* avoided costs. The Projects echo West Penn's interpretation of Section 527 as requiring utilities to pass any savings that exist to customers rather than retaining a profit on purchases of power from QFs.

On this issue we agree with the ALJ's R.D. Armco/Allegheny's argument is based on stretched logic and, if accepted, would result in an interpretation of Section 527 that would violate federal law. When promulgating its rules under PURPA 210, FERC considered and rejected arguments that rates to QFs should produce savings to customers. FERC mandated that rates for purchases be set at a utility's *full* avoided costs. *Small Power Production and Cogeneration Facilities; Regulation Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, Docket No. RM79-55, Order No. 69 (February 19, 1980), 45 *Fed. Reg.* 12214, 12222 (February 25, 1980). The full avoided cost standard was reviewed and approved by the U.S. Supreme Court in *American Paper Institute v. American Electric Power Service Corp.*, 461 U.S. 402 (1983). Therefore, unless and until the full avoided cost standard is revised by FERC, any interpretation of Section 527 as requiring discounts from full avoided costs would be unconstitutional. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Armco/Allegheny's argument that negotiated rates are not governed by PURPA is equally invalid. Although FERC's and this Commission's regulations allow a QF to voluntarily accept rates below a utility's avoided costs, there is nothing to support an argument that a utility cannot voluntarily agree to pay full avoided cost-based rates. If this were so, a utility could not voluntarily comply with PURPA 210! Rather, utility compliance with PURPA could be achieved only upon the filing of a formal complaint. This is clearly

unsupported and we reject Armco/Allegheny's argument in its entirety.

6. *OCA's Correction to Milesburg's EEPA, R.D. at 97-100.*

This issue was addressed in Phase I of the ALJ's R.D. We will address it in Phase II. Our intention is that Phase I issues addressed in our Order be applicable to all four proceedings. Issues that are specific to an individual Project will be discussed in Phase II, and our Order(s) in Phase II will be specific as to each individual docket number.

7. *Capacity Costs Allocated on a Demand/Energy Basis, R.D. at 101-105.*

This rate structure issue involves the methodology by which QF capacity payments will be recovered from ratepayers. Currently, all QF costs (energy and capacity) are recovered through West Penn's Energy Cost Rate mechanism ("ECR"). West Penn currently has approximately 135 MW of QF capacity on-line. The Projects in these proceedings represent another 205 MW. While rates paid to Monongahela, Milesburg, Burgettstown and Shannopin will not be reflected in customers' bills until the Projects are financed and constructed, West Penn's existing ECR recovers all costs paid to QFs on an energy or kwh basis. WPPII and Armco/Allegheny advocate recovery of QF capacity payments from ratepayers on a demand/energy basis through the ECR in a manner similar to that which would have occurred if the capacity had been built by West Penn and the costs allocated on cost-of-service principles in base rates. Armco/Allegheny advocated the adoption of a particular mechanism to achieve a demand/energy allocation based on a single coincident peak methodology.

The OCA opposed Armco/Allegheny's proposal on the basis that (1) it would add complexity to West Penn's

ECR; (2) the single coincident peak methodology was not utilized for Bath County; (3) a single coincident peak methodology could result in volatile changes in cost allocations depending on peak responsibility for a single day; and (4) the rate structure issue has not been set for decision by the Commission in these proceedings.

The ALJ concluded that both Armco/Allegheny and OCA were correct. Finding that the reasons for using a demand/energy allocation are sound, but that the allocation should not be set in this proceeding, the ALJ recommended that West Penn be directed to make a demand/energy allocation in its next ECR filing, and that all existing on-line QF capacity be included. OCA excepted, reiterating its position that no action on the rate structure issue should be taken in these proceedings. OCA states that the Commission has never held that it is necessary to determine QF rate structure years in advance of the time when the costs will be collected from customers. OCA also states that no notice was provided to ratepayers that rate structure issues would be determined in these proceedings. North Branch also excepts, stating that West Penn's Petition for Approval of the North Branch EEPA did not request approval to pass the costs through to ratepayers pursuant to any particular allocation method, and that the allocation issue should be decided in a separate proceeding.

WPPII's Reply Exceptions state that the Commission has expressed an unwillingness to review the demand/energy allocation of QF purchased power costs in the context of an ECR proceeding, and that the ALJ recommended only that the *principal* of a demand/energy allocation be adopted in this proceeding, leaving the particular methodology to a later proceeding where all parties will be afforded an opportunity to be heard. WPPII notes that West Penn currently is collecting QF purchased power costs through its ECR. WPPII argues that the rate structure issue is relevant to these proceedings be-

cause rate recognition permits West Penn to recover costs through its ECR mechanism. WPPII states that ratepayer indifference embodied in PURPA should be preserved. Finally, WPPII states that modifying the practice of allocating QF capacity costs on a kwh basis will alleviate any need for industrial intervention in QF development.

Armco/Allegheny's Reply Exceptions state that the demand allocation issue is within the scope of these proceedings because: (1) failure to allocate capacity costs on a demand basis would violate the underlying premise of PURPA of customer indifference; (2) West Penn's rate recovery petitions sought ECR pass through; and (3) the ALJ did not recommend that any particular type of allocation be adopted in these proceedings.

We agree in part with the ALJ's recommendation and adopt the R.D. on this issue up to the conclusion of the first paragraph on p. 104. However, the ALJ's statement that the costs in question will not be recovered until West Penn's next ECR proceeding is inaccurate. The capacity costs at issue in these proceedings will not be recovered for several years as the Projects proceed to financing construction. Therefore, there is no overriding necessity to revise West Penn's ECR in its next ECR filing.

This rate structure issue is one that will take on added importance in the future as utilities begin to substitute purchases from QFs for their own construction. If QFs begin to represent a more significant portion of a utility's installed capacity, continued recovery of capacity charges on an energy basis through a fuel clause mechanism would incorporate a bias against high load factor customers (usually energy intensive industrial customers). While we have strongly supported the continued development of cogeneration and small power production as in ratepayers' best long-term interests, a rate structure bias against a particular customer class certainly would not be our intent. In order to fully analyze the complexities

inherent in a modification to West Penn's ECR so as to achieve ratepayer indifference, we will require a report and recommendation from our Bureau of Audits, with the assistance of the Law Bureau, on how best to proceed. Upon receipt of this report we will determine whether opening a formal investigation into West Penn's ECR or some other action is required. As stated above, the capacity costs currently being recovered through West Penn's ECR are not substantial, and there is no overriding need to implement an ECR modification in West Penn's next ECR filing. Our preference is to proceed on this issue at a slower pace to ensure that the final result will accomplish our objectives. Therefore, we will request the Audits/Law Bureau report within three months of the date of this Order and will endeavor to initiate formal action shortly thereafter.

8. *Excess Capacity, R.D. at 105-107.*

The ALJ recommended a finding that the addition of the QF capacity under consideration does not result in excess capacity under Section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, with respect to the capacity itself or as to any existing West Penn capacity.

The OCA's Exceptions request clarification of the scope of the excess capacity determination. Specifically OCA requests a finding that the QF capacity in these proceedings *must* be considered in determining whether *future* West Penn plant additions represent excess capacity. No Reply Exceptions were filed.

We affirm the ALJ's decision on this issue. Section 5.3(i) of each of the EEPAs at issue requires, as a condition precedent to West Penn's obligations thereunder, that the Commission either adopt policy guidelines or enter an order to the effect that the QF capacity in question will not be treated as "excess capacity" under Section 1323 either as to the projects themselves or as to any existing West Penn capacity, including the Bath

County project. That determination has been made. We see no need to clarify the determination as OCA has suggested. To do so would constitute ruling on the merits of a case that is not before us and clearly would be improper. However, we note in general terms that it has never been our intention to exclude consideration of existing QF capacity from excess capacity determinations for future utility plant. A more specific statement is not appropriate at this time.

9. *Conclusion.*

Phase I of our Order addresses issues that are applicable to each Project and is hereby adopted with respect to all four proceedings and docket numbers under consideration. Resolution of Phase I issues concludes our Order with respect to the Monongahela and Shannopin EEPA. On the basis of Phase I of our Order, the capacity credits of 3.6¢/kwh and 4.0¢/kwh for Monongahela and Shannopin, respectively, are approved. Orders specific to these two proceedings are appended to this order. Phase II issues remaining for consideration are specific to the Milesburg and Burgettstown Projects. Phase II of our Order in turn will be separated between Docket Nos. P-870216 (Milesburg) and P-880284 (Burgettstown).

## B. PHASE II—BURGETTSTOWN

### Docket No. P-880284.

North Branch filed a Petition for Modification of its EEPA on April 5, 1989 requesting modification of milestone dates and an increase to its capacity rate to reflect the delay in its in-service date occasioned by the lengthy approval process to which it has been subjected. The capacity credit for Burgettstown was based on the Project being placed in service on October 1, 1991. Among other related milestones, under its EEPA Burgettstown must hold a full financial closing before October 1, 1989 or its EEPA will by its own terms expire. Although West Penn

filed the Burgettstown EEPA with the Commission for approval in January 1988, unforseen circumstances have delayed approval for nearly two years. Without Commission approval of the EEPA in the form of a final and *nonappealable* Commission Order, financing and construction cannot take place. As a result, it is impossible for Burgettstown to meet its contractual milestones. North Branch presented unrebutted testimony that financial closing would take six (6) months from the date of a final and nonappealable order, and that construction would take approximately thirty-three (33) additional months, for a total of thirty-nine (39) months.

The ALJ recommended that North Branch's Petition for Modification be denied. North Branch excepts to the ALJ's failure to recommend modification of the milestones in its EEPA. North Branch also excepted to the failure of the ALJ to recommend an increase to its capacity credit of 3.6¢/Kwh. However, on September 8, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for an increase to its capacity credit. Therefore, the only issue before us is whether or not North Branch's request for an extension to its financing and related milestones should be granted.

North Branch states that the ALJ's recommendation not to modify the various milestone dates is illogical because litigation before the Commission has prevented North Branch from meeting the milestones. Although the ALJ recommended that North Branch's EEPA be approved, approval of the EEPA without the requested modification effectively cancels the EEPA and rewards the intervenors for having presented a meritless case. With respect to the ALJ's characterization of North Branch's request for an extension as open-ended, North Branch states it requested six (6) months from a final order for the Financing Closing Date, which is not open-ended. Given the fact that the plant does not have to be in-service until October 1, 1995 to meet West Penn's

needs, the Financing Closing Date could occur as late as January 1, 1993 without presenting a risk to West Penn's planning process. North Branch states that the Commission should consider the environmental and economic benefits of the Burgettstown Project, the substantial savings to ratepayers from the Project, the inequity of not granting the extensions, the great effort and expense incurred by the developers, and the reasonableness of the modifications requested when reviewing North Branch's Exception.

West Penn's Reply Exceptions state that the extensions entail risk to ratepayers that West Penn will not have sufficient time to replace the capacity at a reasonable cost if the Project fails to go in-service at a time when the need is critical. West Penn asserts that projects of this magnitude require years of lead time before construction commences. West Penn states that the developer has the ability to limit its exposure and walk away from the Project at any time, while West Penn does not have the same luxury with respect to its obligation to serve its customers. West Penn states that the ALJ properly questioned whether forced extensions of milestone dates in fully negotiated contracts for an unpredictable period of time should take precedence over a utility's obligation to serve.

Armco/Allegheny's Reply Exceptions argue that the Commission cannot turn a negotiated PURPA contract into a non-negotiated PURPA contract if the resulting contract is not in compliance with federal and state regulations. Armco/Allegheny state that, if Burgettstown is no longer satisfied with its EEPA, it is free to seek a non-negotiated agreement in compliance with the state and federal regulations through the initiation of a new proceeding at the Commission.

We will reverse the ALJ's recommendation on this issue. The Burgettstown Project has been before us for approval since January 1988. Due to unforseen events,

primarily the issuance of the Commonwealth Court decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*"Milesburg"*) and the resulting necessity to initiate a bill insert notification procedure and evidentiary hearings thereafter, resolution of this proceeding has been delayed substantially. In essence, a proceeding that began as a request for a declaratory order evolved in a vigorously contested rate proceeding that took over twice as long to complete as a major general rate increase proceeding under 66 Pa. C.S. § 1308(d). At today's conclusion of the proceeding, we have affirmed the ALJ's recommendation and found that the Burgettstown EEPA should be approved as providing for rates that are at or below West Penn's avoided costs. If we were to deny North Branch's request for modification to its milestone dates, its EEPA with West Penn would expire by its own terms on October 1, 1989. This result would be untenable, akin perhaps to a doctor meticulously evaluating diagnostic procedures for a patient that died for want of treatment.

In our view it is essential that regulatory delay in the proceeding be recognized and reflected in our Order. To do otherwise would merely extend an open invitation to interventions in opposition to future QF proceedings since intervenors would realize that they could win by default, through the passage of time alone, results that could not be won on the merits. Although we are cognizant of West Penn's concerns regarding orderly capacity planning, our failure to grant North Branch the requested extension would leave an 80 MW shortfall in West Penn's generation plans. If West Penn attempted to make up for the shortfall by beginning the contract negotiation process anew with another developer, we would question the fate of that contract as well in the face of probable opposition and a Commission policy against reflecting and accounting for regulatory delay. To date North Branch has completed substantial development work and

the lengthy review process by the Commission finally has been completed. North Branch is ready to proceed to financing, barring any appeals of our Order. Therefore, to in essence "pull the plug" on the Burgettstown Project at this late stage would inject the very uncertainty in West Penn's generation plans that it seeks to avoid. Similarly, it is no answer to, as Armco/Allegheny suggest, require North Branch to begin anew with a new evidentiary proceeding to obtain a contract with West Penn at rates established under the Commission's regulations. The point of requiring North Branch to begin from square one with a complaint proceeding requesting rates higher than the ones it has accepted is lost to us, unless of course the point is to defeat this Project through a war of attrition.

We therefore will grant North Branch's petition for modification and extend the Financing Closing Date to six months after the issuance of a final nonappealable Commission Order in this proceeding, with corresponding adjustments to related contractual milestones. We also will grant North Branch's August 21, 1989 Application for Stay of the Financing Closing Date in recognition of the fact that, under Section 508, 66 Pa. C.S. § 508, an Order modifying a contractual provision does not take effect until thirty (30) days after it is entered. Therefore, the effect of Section 10.2(c) of the EEPA will be stayed pending the effective date of the portion of our Order granting the contractual modifications.

## C. PHASE II—MILESBURG

### Docket No. P-870216.

As stated above, Milesburg's contract has been before the Commission and/or the Commonwealth Court since April 2, 1987. The issuance of the Commonwealth Court's decision in *Milesburg* in August 1988 necessitated the preparation and mailing of a bill insert notice and the holding of hearings before an ALJ. The ALJ

has recommended, and we have adopted, an Order affirming the reasonableness of the input assumptions utilized by West Penn's in the calculation of its avoided costs.

The capacity credit of 3.3¢/Kwh in the EEPA was based on an in-service date in 1990. Milesburg's original Financing Closing Date of September 1, 1988 was extended to February 28, 1989 by a Consent Order entered into by all parties and approved by the Commission on September 1, 1988. On February 9, 1989 Milesburg filed a petition to, *inter alia*, further extend its Financing Closing Date. Although the ALJ issued an order on February 21, 1989 granting the petition, he rescinded it on February 27, 1989 in recognition of the fact that it was issued without a hearing as required by Section 508 of the Public Utility Code, 66 Pa. C.S. § 508. N.T. at 7. On March 3, 1989 Milesburg filed a Petition for the Issuance of an Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order. Milesburg requested that the Commission issue an emergency order granting relief from the Financing Closing Date of February 28, 1989 or, in the alternative, reinstate the portion of the ALJ's February 21, 1989 Order that extended the Financing Closing Date while remanding the issue to the ALJ for a hearing on the merits. West Penn and Armco/Allegheny filed responsive pleadings in opposition to Milesburg's March 3, 1989 emergency petition. By Order entered March 31, 1989 the Commission denied Milesburg's request for an Emergency Order but granted limited interlocutory review of the ALJ's February 27, 1989 Order and required all parties to maintain the status quo with respect to the EEPA pending consideration by the ALJ, and ultimately the Commission, on Milesburg's February 9, 1989 petition for modification. Our Order parenthetically noted that:

> [I]t may be in the interests of West Penn and its ratepayers to retain [Milesburg] under a voluntary agreement setting forth a negotiated rate for the sale

of power. Absent a negotiated rate, [Milesburg] is entitled to a capacity (and associated energy) rate determined in accordance with our regulations. A key issue of first impression would be the time frame to be utilized in determining [Milesburg's] avoided cost-based rate. Although we express no opinion on this issue at this time, our preliminary observation is that [Milesburg's] situation may be distinctly different from the situation considerd by us in *Petition of Pagnotti Enterprises,* Docket No. P-870281 (August 19, 1988). In *Pagnotti,* a negotiated purchased power rate had been approved by the Commission on June 30, 1986, and our June 30, 1986 Order became final and nonappealable on July 30, 1986. The project participants in that proceeding failed to meet, in large part, an agreed-upon financing deadline of December 31, 1986, which occurred approximately five (5) months after the issuance of the final, nonappealable order that is necessary for a project's financing. We found in *Pagnotti* that, by missing the financing deadline, the project participants had waived their entitlement to rates based on Pennsylvania Power & Light Company's ("PP&L's") avoided cost projections as of the time that serious negotiations took place, and that the project therefore was entitled to rates based on PP&L's avoided costs projections as of January 1, 1987. In the instant proceeding, [Milesburg] has never been the beneficiary of a final, nonappealable Commission Order approving rate recovery of amounts proposed to be paid by West Penn. In fact, [Milesburg's] agreement with West Penn has been before the Commission and/or the Commonwealth Court for nearly two years. Without a final nonappealable Commission Order, a project such as [Milesburg's] cannot receive financing. Therefore, it may be that, if asked to rule upon this issue of first impression in Pennsylvania, we may determine that

> [Milesburg] has not waived its entitlement to rates based on West Penn's avoided costs as of the time that serious negotiations between West Penn and [Milesburg] took place;

Order at 8-9.

The ALJ recommended that Milesburg's requests to extend its milestone dates and to revise its capacity credit to reflect its delayed in-service date be denied. In the event that the Commission reversed this recommendation, the ALJ recommended that Milesburg's capacity credit be recalculated by incorporating a change in West Penn's methodology to reflect monthly, as opposed to annual, payments.

Milesburg excepted, stating that it has been clearly demonstrated that the requested modified rates are at or below West Penn's avoided costs and substantially below the rates to which Milesburg is entitled under the regulations, and that the Project will bring considerable economic and environmental benefits to Pennsylvania. Milesburg states that the requested modified capacity rates are merely the rates that would have been available to it had the delayed in-service date been anticipated. Milesburg asserts that the ALJ's suggestion that Milesburg initiate another proceeding to seek rates under the regulations is illogical because it would cost the ratepayers more for power. Milesburg argues that there never was any intent that the Commission intended to forego review of Milesburg's request, notwithstanding the fact that its EEPA lapsed on February 28, 1989. Milesburg points to language in the September 1, 1988 Consent Order as indicative of an agreement among the parties that the Commission would consider an extension beyond February 28, 1989. Milesburg further points to the Commission's Order of March 31, 1989 as indicative of the Commission's intent that the petition for modification be considered on the merits. Milesburg avers that if the ALJ had correctly recognized the Commission's intent

and authority to modify the EEPA, the ALJ would have found the modifications to be in the public interest. Milesburg takes specific exception to the conclusion of the ALJ that there is no evidence on the record upon which to conclude that West Penn is hostile to the Projects, since West Penn refused on two occasions to negoiate modifications to the EEPA, and to the conclusion that West Penn would not have sufficient time to replace the Milesburg capacity should it fail to go in-service. Milesburg states that there is no evidence on the record that indicates Milesburg would fail if its milestones were extended, or that West Penn could not replace the Milesburg capacity. Milesburg states that arguably ratepayers would be better off if the milestones were extended since they would not pay for capacity until a date closer in 1995. Milesburg states that it would be erroneous to deny the extensions based on the fact that the Commission's Order may be appealed—rather, the modifications should be decided on the merits as opposed to the fear of appeals by industrial intervenors. Milesburg states it was incorrect to link consideration of the request for milestone extensions with the request for capacity rate modifications since each issue should be viewed separately on the merits. Milesburg objects to the fact that the ALJ gave little consideration to the fact that Milesburg has spent substantial time and money to advance its Project, noting that adoption of the ALJ's recommendation would discourage other developers from risking an undertaking in Pennsylvania.

With respect to the ALJ's recommendation to deny the request for increased capacity rates, Milesburg notes that it is merely attempting to duplicate the EEPA that would have been available to it under West Penn's methodology had the regulatory delay been anticipated, and that it is not inconsistent with the serious negotiations standard to use 1986 assumptions with a modified in-service date for the Project. Finally, Milesburg objects to the ALJ's conclusion that the September 1, 1989 Consent

Order bars any modification to the capacity credit since the rates requested are not in excess of the rates in the EEPA corrected for the new in-service date.

With respect to the ALJ's recommendation to modify the methodology utilized for calculating its capacity credit (in the event the Commission ordered extensions to the milestones), Milesburg states that the reduction would be in error since either the Commission's regulations or West Penn's methodology at the time the EEPA was negotiated is the proper benchmark.

OCA's Exceptions regarding the portion of the R.D. pertaining to modifications to capacity credits state that the ALJ's conclusion that the notice issue would not bar an increase is in error. OCA states that notice would have to be given if any significant increase to the originally noticed EEPAs is granted. Armco/Allegheny similarly excepted to this finding.

West Penn's Reply Exceptions addressed Phase II issues for Burgettstown and Milesburg together. A brief description of West Penn's Reply Exceptions on the milestone extensions is set forth in the previous section of this Order. With respect to the requested increase to the capacity rates, West Penn states that Milesburg's argument that updating the rate is not an increase is a strained reading of the Consent Order. West Penn states that the EEPA automatically terminated on February 28, 1989 and that the Commission therefore has no authority under Section 508 to modify it. West Penn states that the Commission has no authority to order a new contract because avoided costs must be determined at the time a legally enforceable obligation is incurred. West Penn asserts that, since the EEPA lapsed, it has no legally enforceable obligation.

OCA's Reply Exceptions do not address the request for extensions to milestone dates. However, OCA supports the recalculation under West Penn's revised methodology of Milesburg's capacity credit, stating that the purpose

of the proceeding is to determine West Penn's avoided costs and set rates accordingly. With respect to Milesburg's request for an increase to its capacity credit, OCA states that if rates are locked in as of the time of serious negotiations they cannot be revised, and to do so would give the QF the best of both worlds. Finally, OCA states that Milesburg's on-line date of January 1990 was 33 months from the date West Penn's rate recovery petition was filed and that it is unlikely that the on-line date would have been met under any circumstances.

Armco/Allegheny's Reply Exceptions state that Section 508 does not empower the Commission to modify a contract that has lapsed and that an increase to rates would violate the September 1, 1988 Consent Order.

The Project's Reply Exceptions take issue with OCA's and Armco/Allegheny's argument that an additional bill insert would be required before granting an increase to the capacity credits. The Projects state that the bill insert provided all interested parties with sufficient notice of the nature of the hearing, and that the ratepayers are well represented in these proceedings. The Projects state that a new notice is not required by the Commission every time an impact is modified during the course of a rate proceeding.

On Milesburg's Phase II issues, we reverse the ALJ. In our opinion the resolution of these issues is clear. We agree with the ALJ that Milesburg's EEPA has lapsed and that modification to the EEPA under Section 508 is a moot point. Nevertheless, Milesburg has been endeavoring to obtain an approved power purchase agreement with West Penn since 1986. Although West Penn does not have a legally enforceable obligation to purchase power under the lapsed 1987 EEPA, it does have a legally enforceable obligation under PURPA 210 to purchase Milesburg's power at rates determined in accordance with West Penn's avoided cost projections in effect in 1986.

The Commission has the responsibility to enforce the provisions of PURPA 210 in Pennsylvania. Milesburg has requested rates based on West Penn's methodology, which we have determined to be the appropriate benchmark of avoided costs in these proceedings. Milesburg has done nothing to waive its entitlement to rates based on avoided costs as of the time of serious negotiations. Therefore, it is our responsibility to require West Penn to enter into a new EEPA with Milesburg, identical in terms with the lapsed EEPA, with extensions to the milestone dates and revised capacity rates that reflect the Project's later in-service date. Specifically, we will require a financing closing date six months after the issuance of a final and nonappealable Order, with similar extensions to related milestones. With respect to the capacity rates, we find no inconsistency with reflecting the Project's later in-service date in the calculation under West Penn's methodology. All of the inputs regarding West Penn's avoided costs will remain the same. The in-service date is not a component of West Penn's avoided costs, or the cost of the 300 MW coal unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's avoided *costs* do not change with changes in a Project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

With respect to the issue of whether or not the Consent Orders bars any increase to Milesburg's capacity credit, a reasonable interpretation thereof is that Milesburg agreed to forego an increase based on the six month extension agreed upon by all of the parties. In other words, a reasonable interpretation is that the *quid pro quo* for getting parties to agree to the limited six month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months. Therefore, we will deduct six months from the anticipated financing and construction period of 36-42 months and

set the in-service date at 30 months past the issuance of a final and nonappealable Order in this proceeding.

With respect to the use of the revised West Penn formula, we agree with the ALJ that the capacity credit should be calculated using the revision. West Penn "fine tuned" its methodology after the issuance of price proposals to Milesburg. Since we are requiring the execution of a new contract, the revision should be incorporated.

With respect to the suggestion of the ALJ that Milesburg be required to seek a contract in a new evidentiary proceeding under the Commission's regulations, we find that such a requirement would make no sense. Milesburg should not be denied rates based on West Penn's methodology and forced to seek *higher* rates. Moreover, requiring Milesburg to begin anew with another vigorously contested proceeding likely would result in the abandonment of this Project. For the policy reasons set forth in the section of the Order addressing Burgettstown's Phase II proceeding, we find that a failure in this proceeding to recognize and account for regulatory delay would have consequences contrary to the public interest.

Finally, we agree with the ALJ's recommendation regarding the notice issue. The original bill insert provided adequate notice to ratepayers of the nature of these proceedings. We cannot help but note that all of the active parties to these proceedings were before us before the preparation and issuance of the bill insert. In other words, the bill insert elicited no active parties. Therefore, a finding that a new bill insert would be required before granting Milesburg's request for modified capacity rates would elevate form over substance; THEREFORE,

Petition of West Penn Power Company Re: Monongahela Lock and Dam No. 8.

Docket No. P-880283

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Noah Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn Power Company Re: Shannopin Mine Project — Docket No. P-880286

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Mon Valley Energy Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn Power Company Re: Burgettstown Project — Docket No. P-880284

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with North Branch Energy Partners, L.P. ("North Branch") is granted.

2. That the Petition of North Branch for modification of its EEPA is granted insofar as the Financing Closing Date will be extended to six months after the issuance of a final and nonappealable Order in this proceeding and related contractual milestones will be adjusted accordingly.

3. That North Branch's Application for Stay of the effect the Financing Closing Date is granted.

4. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

5. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

6. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

7. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn
Power Company Re: Docket No.
Milesburg Energy, Inc. P-870216

IT IS ORDERED:

1. That West Penn Power Company ("West Penn") is directed to enter into an Electric Energy Purchase Agreement ("EEPA") with Milesburg Energy, Inc. within thirty (30) days of the date on which this Order becomes final and nonappealable. The terms and conditions shall be identical to the 1987 EEPA with the milestone extensions and capacity credit modifications set forth in the foregoing Order.

2. That the rates established by the resulting EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

## APPENDIX K

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17120

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Public Meeting Held September 21, 1989
Agenda No: ALJ-124

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Docket No: P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER

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DISSENTING OPINION OF COMMISSIONER
FRANK FISCHL

I must disagree with the majority's resolution of these issues. Each resolution exposes the ratepayers of West Penn Power to escalating expenses and associated risks from purchases from qualifying facilities.

The Office of Consumer Advocate (OCA) and Armco/Allegheny Ludlum (AAL) have vigorously contested the level of capacity credits. The credits were derived using West Penn's methodology. The OCA and AAL have challenged the level of credits for a number of reasons. Adoption of any one adjustment would substantially reduce the credit payments. Clearly the credits calculated are above avoided cost and should be reduced.

It is ironic for the majority to conclude that these cogeneration contracts are in the best interest of ratepayers when the OCA, representing residential customers and Armco/Allegheny, two of the largest industrial customers, believe they are not.

The majority further concludes that the reasonableness of the credits is to be judged by a comparison to rates that would be required by the commission's regulations. It is argued that since credits calculated by commission regulation would be per se reasonable, lower credits calculated under West Penn's methodology are per se reasonable as well.

There are two fatal flaws to this argument. The first flaw is that proper application of the commission's regulation indicates that the qualifying facilities should receive no capacity credits whatsoever. (OCA main brief pages 77-80). The second flaw is the lack of discounting to determine the present avoided cost of future capacity additions. (OCA main brief pages 73-74). In fact, reliance on the commission's regulation *guarantees* rates in excess of avoided costs and therefore violates PURPA. The rate calculated by commission regulation cannot be used as a bench mark because the rate will *always* be greater than the rate under West Penn's methodology due to the lack of discounting. Rather than "binding all in Pennsylvania", the regulation should be waived. It is impossible to argue the per se reasonableness of rates based on regulations that do not apply and that involve a defective formula. Avoided cost cannot be defined by regulations.

The resolutions of the so-called Phase II issues are novel and erroneous. Commission regulations clearly state that "nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities." (52 Pa. Code § 57.32) It is unclear why certain sections of our regulations are "binding" while other sections are completely ignored.

The use of milestones is appropriate. Our regulations state: "A qualifying facility is eligible for a capacity credit as stated in this subchapter only if it enters into a contract or other legally enforceable obligation with the purchasing utility including termination notice requirements and sanctions for noncompliance." (52 Pa.

Code § 57.34) The mutually agreed to financial closing milestone for Milesburg passed unfulfilled on March 1, 1989. The contract does not exist; therefore, Section 508 of the Public Utility Code cannot apply. The majority acknowledges as much. The majority; therefore, ordered West Penn to execute a new contract with the developers. They fail to cite any authority for such action, nor in my opinion does such authority exist.

The Commission has previously answered the question of lapsed milestones. (Petitions of Pagnotti Enterprises, Inc. P-860171, P-870281) Pagnotti held that when a qualifying facility does not meet agreed-upon milestones pursuant to a privately negotiated arrangement, the qualifying facility has waived its entitlement to previously available rates and is entitled only to rates based on "later avoided cost projections." Not only is this precedent ignored, the rates to be paid are actually *increased*. The consent order signed by the parties extending the financial closing deadline clearly bars any increase in the capacity. The majority's "reasonable interpretation" that only an increase based on the intervening six months is barred is contrived and without support.

Milesburg's assertion that if required to initiate another proceeding the rates sought would be higher is incorrect. If the Milesburg developers thought for one minute they could compel higher rates through another proceeding, they would have initiated one by now. Per our regulations, Milesburg is not entitled to capacity credits without a contract. (52 Pa. 57.34)

As for the Burgettstown Project, the majority attempts to use Section 508 of the Public Utility Code to justify the stay and extension of the financial closing date. Suffice it to say that if Section 508 has not been challenged previously, it will be challenged now. For support, the majority characterizes a Commonwealth Court decision as an unforseen event, provides a bizarre medical analogy and suggests that any other conclusion "pulls the plug" on

the project. First, Section 508 should not apply. The inability of certain developers to meet voluntarily agreed to milestone dates simply does not rise to a level contrary or adverse to the public interest and general well-being of this Commonwealth. Second, if applied, the modification is effective 30 days after entry of the Commission order. The Electric Energy Purchase Agreement (EEPA) lapsed October 2, 1989. Again, there is no contract to modify.

The majority has misconstrued the Commission's proper role in this case. The Commission has never approved or disapproved a negotiated contract but has simply approved future cost recovery in the energy cost rate or some similar mechanism. As for Milesburg, the Commission has no idea of the rates being approved because "the particular capacity credit cannot be determined at this time." (Motion of Chairman Shane, page 4) The majority does not know how much, only that it is just and reasonable.

To dismiss energy efficiency as "superficially appealing but groundless" is misguided and unfortunate. (Motion of Chairman Shane, page 2). Was not the spirit of PURPA energy efficiency? Where is the efficiency if consumers are charged equal rates whether the source is Milesburg or West Penn Power?

The demand/energy allocation of capacity charges is a red herring. If the contracts were priced appropriately, no incentive would exist for inter-class cost transfer. A rate structure biased against a particular customer class is not the majority's intent, a level of rates biased equally against all customer classes is quite another matter.

As for the recognition of regulatory delay, if the developers are blameless, then who is to blame? Commonwealth Court, this commission? As to the motives of the intervenors, no reason is given, nor does one exist why intervenors would attempt through hearings and appeals to block bargain priced electricity.

The recognition of regulatory delay shifts more risk onto West Penn's ratepayers. An indefinite financial deadline clearly interfers with utilities' ability to plan future generation. The utility could easily end up capacity short or with excess capacity. The lead time necessary for the coal plants supposedly avoided here is about ten years. Planning is impossible in the present situation where these projects are given open-ended deadlines. Blaming regulatory delay is no answer.

In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. (Order page 13) Obviously then the financial closing dates were chosen under similar conditions. To suggest that the financial closing could occur at late as January 1, 1993 without presenting a risk to West Penn's planning process is grossly in error. Capacity planning is a continual process necessitating constant update and reevaluation. To suggest that West Penn's planning process be held in abeyance until January 1993 or later is absurd. If there is an 80 megawatt hole in West Penn's generation plan; it has been created by the majority decision.

The Commission regulations were intended to equalize the bargaining power of developers vis-a-vis the utilities. The majority have swung the pendulum too far toward the developers and away from the ratepayers who are the final guarantor of the payments and terms approved here.

This decision has eliminated the need for negotiated contracts. Developers can simply dictate terms and have the Commission order the utility to execute the appropriate contract.

/s/ Frank Fischl
FRANK FISCHL
Commissioner

October 6, 1989
Date

**APPENDIX L**

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

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No. 2091 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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Before: HONORABLE JAMES CRUMLISH, JR.,
President Judge
HONORABLE DAVID W. CRAIG, Judge
HONORABLE JAMES GARDNER COLINS, Judge
HONORABLE MADALINE PALLADINO, Judge
HONORABLE BERNARD L. MCGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE DAN PELLEGRINI, Judge

ARGUED: APRIL 4, 1990

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MEMORANDUM OPINION BY JUDGE CRAIG
FILED: July 17, 1990

Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), two large industrial customers of West Penn Power Company (West Penn), have jointly appealed from an order of the Pennsylvania Public Utility Commission (PUC or Commission) granting West Penn's petition for approval of the

terms and conditions of an electric energy purchase agreement (EEPA or contract) between West Penn and the Mon Valley Energy Corporation (Mon Valley) and authorizing recovery from ratepayers of the costs West Penn will incur under the contract.

Mon Valley proposes to build and operate a qualifying cogeneration facility (QF) within the meaning of section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 796.[1]

The issue here is whether the PUC has the authority to approve passthrough to ratepayers of avoided capacity costs[2] embodied in such a contract, where those costs were calculated on the basis of conditions (specifically, corporate income tax rates) at the time during negotiations when the QF and the utility first reached agreement

[1] PURPA defines "cogeneration facility" as one that produces both electric energy and steam or some form of useful energy, such as heat, 16 U.S.C. § 796(18)(A), and it defines "small power production facility" as one that has a production capacity of no more than 80 megawatts (MW) and uses as a primary energy source biomass, waste, geothermal resources or renewable resources such as wind, water or solar energy to produce electric power, 16 U.S.C. § 796(17)(A). Together they are commonly known as "qualifying facilities" or QFs.

[2] Energy costs are the variable costs associated with the production of electric energy—the cost of fuel and some operating and maintenance expenses. Capacity costs are those associated with providing the capability to deliver energy—primarily the capital costs of facilities. *See* the preamble to the publication of 18 C.F.R. § 292.101, the definitions section of the regulations promulgated by the Federal Energy Regulatory Commission (FERC) pursuant to PURPA, 45 Fed. Reg. 12216. FERC concluded that "[i]f a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided capacity and energy costs. *Id.* No party has challenged the energy rates provided in the Shannopin EEPA.

in principle on price, rather than at the time when the parties executed the contract or the QF otherwise incurred a legally enforceable obligation to deliver power to the utility.[3]

*History*

West Penn and Mon Valley [4] began discussions in February of 1986 regarding the development of a qualifying cogeneration facility proposed to be built by Mon Valley at the Shannopin Mine near Bobtown, Greene County (Shannopin Project). The Shannopin Project is designed to be a coal-fired cogeneration facility producing up to 80 megawatts (MW) of electric energy to be sold to West Penn and thermal energy to be sold to the Shannopin Mining Company for drying coal.

On September 10, 1986, West Penn and Mon Valley reached an oral agreement in principle that the capacity rate for West Penn's purchase of power from Mon Valley would be a levelized rate of 4.0 cents per kilowatt hour (KWH). West Penn sent a firm price proposal to Mon Valley on October 17, 1986, confirming that capacity rate for a September 1992 in-service date and a thirty-year contract term, and calling for the finalizing of a term sheet within three months (a schedule later modified by the parties). All term sheets used by the parties during the negotiations, including the last, from May of 1987, contain a provision stating that the term sheet is intended solely for the convenience of the parties as a basis for ongoing negotiations of the terms of the EEPA, that it is not binding on either party, and that the parties reserve

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[3] This appeal is closely related to two other appeals by Armco/Allegheny and West Penn from the PUC's orders, in the same opinion, involving EEPAs between West Penn and Milesburg Energy, Inc. (Nos. 2092 and 2074 C.D. 1989) and between West Penn and North Branch Energy Partners, L.P. (Nos. 2090 and 2097 C.D. 1989).

[4] Mon Valley is owned and controlled by the Sagamore Corporation, American Ventures, Inc., Nally, Inc. and the Shannopin Mining Co.

the right to agree on different terms, including the amount to be paid by West Penn for Shannopin Project energy pursuant to the final EEPA.

The parties continued to negotiate the other terms of the EEPA through most of 1987. They entered into the final version of the contract on October 15, 1987. That contract contained the 4.0¢/KWH capacity rate, and it conditioned West Penn's obligation to purchase on PUC approval of the contract.

When West Penn first proposed the 4.0¢/KWH capacity rate, in September of 1986, West Penn estimated that its avoided capacity cost would be 4.08¢/KWH, based on avoiding part of the cost of a coal-fired power plant with three 300 MW units scheduled to be in service in 1995, 1997 and 1998, as set forth in the Allegheny Power System Generation Capacity Plan. That capacity rate also reflected a federal corporate income tax rate of 46% and a Pennsylvania corporate income tax rate of 9.5%.

However, on October 22, 1986, the Tax Reform Act of 1986[5] was signed into law. That Act decreased the federal corporate income tax rate to 40% in 1987 and then to 34% in 1988. On January 1, 1987, the Pennsylvania corporate income tax rate changed from 9.5% to 8.5%.

On January 20, 1988, West Penn filed a petition with the PUC for approval and rate recovery of the rates set forth in the EEPA for the Shannopin Project (approval petition), which the PUC docketed at No. P-880286. The Office of Consumer Advocate, the West Penn Power Industrial Intervenors and Armco/Allegheny opposed the petition, asserting that the price was too high, i.e., above West Penn's avoided costs, and so should not be passed on to retail customers. The PUC entered a Tentative Opinion and Order on July 8, 1988, granting West Penn's

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[5] P.L. 99-514, 100 Stat. 2085.

approval petition, without first holding a hearing on the matter.

On August 22, 1988, this court issued its decision in *Barasch v. Pennsylvania Public Utility Commission,* 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296, *reargument denied,* 119 Pa. Commonwealth Ct. 115, 550 A.2d 257 (1988) (*Milesburg I*), a case involving the PUC's approval of an EEPA between West Penn and another QF, Milesburg Energy, Inc. The court held that before the PUC may approve the legality of a contract for a utility's purchase of power from a QF that includes substantial payments for capacity, due process requires that the utility's customers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action, because such approval by the PUC is adjudicatory in nature and involves substantial property rights of ratepayers.

Thereafter, the PUC withdrew its Tentative Opinion and Order granting the approval petition for the Shannopin Project and, on September 30, 1988, consolidated the Shannopin Project proceedings for hearing purposes with two other pending petitions for approval of contracts between West Penn and QFs. Following remand of the record after the court's disposition of the PUC's petition for reargument in *Milesburg I,* the PUC consolidated that case for hearing with the other three and assigned the case to the Office of Administrative Law Judge for hearing and recommended decision.[6]

An Administrative Law Judge (ALJ) conducted a hearing on the consolidated cases over eight days in April

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[6] In the course of denying the PUC's petition for reargument in *Milesburg I,* this court held that because the case presented questions of first impression, the resolution of which could not have been clearly foreshadowed, the decision would have only prospective effect. Therefore, the PUC was not required to provide notice and a hearing in the cases consolidated with the *Milesburg* case, including that relating to the Shannopin Project, but the PUC elected to do so.

of 1989. He bifurcated the hearing into Phase One, relating to a determination of the proper capacity rates to be paid to the QFs, and Phase Two, relating to issues arising from litigation delays. The present case involves only Phase One.[7]

The ALJ issued a Recommended Decision holding that the time of "agreement in principle on price" employed by West Penn in regard to each of these contracts satisfied the Commission's standard of time of "serious negotiations" as the time as of which full avoided costs should be determined. He also approved the time of serious negotiations standard itself. Among the exceptions filed by Armco/Allegheny was a contention that the date when the utility and the QF executed their EEPA should be used to calculate the utility's avoided costs, because that was the date when the QF was legally committed to deliver power.

By Opinion and Order entered September 29, 1989, the PUC essentially adopted Phase One of the Recommended Decision, thus approving West Penn's petition seeking recovery from ratepayers of costs West Penn would pay for power from the Shannopin Project. The PUC adopted the ALJ's recommendation on the issue of the time frame to be used to determine a utility's avoided costs, reiterating its "longstanding policy that avoided costs are to be determined as of the time of serious negotiations."

*Discussion*

Our decision of this date in the related case of *West Penn Power Co. v. Pennsylvania Utility Commission*, —— Pa. Commonwealth Ct. ——, —— A.2d —— (Nos. 2074 and 2092 C.D. 1989, filed July 17, 1990) (*Milesburg II*), controls the outcome here. Although Armco/Allegheny has focused in this case on the effects

[7] For a more detailed description of the proceedings before the ALJ, see *Milesburg II*.

caused by the change in tax rates between the time of agreement in principle on price between the utility and the QF and the time of execution of the contract, the issue actually is identical to the rate issue presented in *Milesburg II*: May the PUC, in a manner consistent with the regulations promulgated by FERC to implement PURPA, authorize calculation of avoided capacity costs for a purchase of power from a QF from a time before the QF incurred a legally enforceable obligation to deliver power?

As we noted in *Milesburg II*, among the regulations promulgated by FERC, pursuant to its mandate from Congress to implement the provisions of PURPA, was 18 C.F.R. § 292.304(d)(2). That regulation provides that where a QF exercises its option to provide energy or capacity pursuant to a contract or other legally enforceable obligation for the delivery of energy or capacity, over a specified term, the rate for such purchases shall, at the option of the QF exercised before the beginning of the term, be based on either the full avoided costs (FAC) calculated at the time of delivery or the avoided costs calculated at the time the obligation is incurred.

Despite the interpretations urged by the PUC, the utility and the QFs, we here also conclude that the language of 18 C.F.R. § 292.304(d)(2) is clear and does not authorize the use of the PUC's serious negotiations standard. Concurring with recent decisions from other jurisdictions,[8] we conclude that, under FERC's regula-

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[8] *See, e.g., Snow Mountain Pine Co. v. Mauldin*, 84 Or. App. 590, 599, 734 P.2d 1366, 1371, *review denied*, 303 Or. 591, 639 P.2d 571 (1987) (QF's self-imposed obligation to deliver energy triggers utility's obligation to purchase, with avoided costs determined from the date the QF obligates itself) and *Appeal of Public Service Co. of New Hampshire*, 130 N.H. 285, 292, 539 A.2d 275, 279 (1988) (PUC's articulated policy of treating the filing of a rate petition accompanied by an interconnection agreement signed by

tion, the time when a QF executes a contract with a utility, or when it otherwise does everything in its power to create a legally enforceable obligation to deliver energy and capacity, is the time as of which the PUC must calculate the avoided costs of the utility for the purpose of determining the reasonableness of contract rates. In the name of implementing the FERC regulations, the PUC may not adopt a policy that is contrary to those regulations.

As the description above of the negotiations between Mon Valley and West Penn demonstrates, Mon Valley did not have a legally enforceable obligation to deliver capacity at the time of agreement in principle on price or any other time before the actual execution of the contract.

This court's scope of review of PUC adjudications is limited to determining "whether or not constitutional rights were violated, an error of law was committed or a finding of fact was unsupported by substantial evidence. . . ." *T.W. Phillips Gas and Oil Co. v. Pennsylvania Public Utility Commission,* 81 Pa. Commonwealth Ct. 205, 208, 474 A.2d 355, 358 (1984); 2 Pa. C.S. § 704. The PUC's approval of recovery from ratepayers of capacity costs under the EEPA between Shannopin and West Penn calculated in a manner contrary to the FERC regulations constituted error of law, and the PUC's action must be reversed.

The ultimate question in this case remains whether the capacity rate in the EEPA is equal to or less than FAC. The PUC's staff once aagin failed to submit its own calculation of full avoided cost into the record. Luckily, the parties and the PUC have approved the method of calculating FAC advanced by West Penn as yielding an accurate determination of the utility's full

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small power producer as legally enforceable obligation is consistent with 18 C.F.R. § 292.304(d)(2)).

avoided cost, which is the standard against which the contract costs must be judged to determine their lawfulness. The dispute in this case concerns only one input—applicable corporate tax rates—to be used in calculating FAC. A calculation of FAC employing the method accepted by all the parties, but using the legally proper tax rates, will address the concerns raised by appellant Armco/Allegheny.

We shall remand this case to the PUC with instructions that the Commission calculate West Penn's full avoided cost and corresponding capacity cost credit according to West Penn's method and using tax rates in effect at the time Mon Valley and West Penn executed their contract, which was the first time Mon Valley had done everything in its power to incur a legally enforceable obligation to deliver energy and capacity. The Commission shall produce a calculation that is binding upon the PUC, and it shall make that calculation part of the record of this proceeding. Because the newly calculated rate will be below the rate that Mon Valley previously agreed to, the PUC shall offer Mon Valley the opportunity to decline to proceed with the project.[9]

The factual issues in this case already have been thoroughly examined in the hearing before the ALJ. Accordingly, the PUC need not provide another hearing with

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[9] The procedure would be the same if a QF petitioned the PUC to compel a utility to purchase power according to the terms of a contract that the QF had tendered to the utility and the utility rejected. Before the PUC could issue such an order, it would have to evaluate the contract rates to make sure that they were not in excess of FAC. If they were, the PUC could offer only to order the utility to purchase at rates equal to FAC, and the PUC would have to offer the QF the option of declining to proceed at the lower rates. This procedure is itself simply a variation on the procedure expressly provided in the FERC regulations, where a QF that is unsuccessful in negotiating with a utility petitions the state PUC to compel the utility to purchase. In such a case the FERC regulations require the PUC to set the purchase rate at full avoided cost. 18 C.F.R. § 292.304(b)(2).

reference to the proper calculation of FAC that we are ordering here. The PUC should, for due process reasons, permit the submission of written objections to its calculation, should any party choose to challenge the accuracy of the computation.

Finally, we note that this case involves a question of first impression, the resolution of which could not have been clearly foreshadowed. Accordingly, our intention is that the decision shall have only prospective effect. *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

/s/ David W. Craig
DAVID W. CRAIG
Judge

Former President Judge Crumlish did not participate in the decision in this case.

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2091 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

ORDER

NOW, July 17, 1990, the order of the Pennsylvania Public Utility Commission at Docket No. P-880286, entered September 29, 1989, is affirmed in part and modified in part. The order is modified so that the approval of the Electric Energy Purchase Agreement between West Penn Power Company and Mon Valley Energy Corporation shall provide that a calculation of the capacity cost credit shall relate to factors in existence at the time the EEPA was signed, October 15, 1987, rather than as of the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of the capacity cost credit, according to the method of calculation employed by West Penn through these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for October 15, 1987. The Commission shall make its calculation part of the record of this proceeding, and it shall supply copies

to the parties, allowing a reasonable period for the submission of written objections to the calculation. Should the new capacity rate prove to be less than that to which the parties initially agreed, the Commission shall offer Mon Valley Energy Corporation the opportunity to decline to proceed with the project.

Jurisdiction relinquished.

/s/ David W. Craig
DAVID W. CRAIG
Judge

**APPENDIX M**

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

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No. 2091 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
*Petitioners*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent*

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ORDER

NOW, September 13, 1990, upon consideration of petition, application, answers and replies, the application for reargument filed by West Penn Power Company is denied, and the petition for reconsideration filed by Mon Valley Energy Corporation, because it pursues an issue not raised below, is also denied.

Armco/Allegheny's motion to strike reply of intervenor Mon Valley to Armco/Allegheny's answer in opposition to petition for reconsideration and to West Penn's application for reargument is granted.

BY THE COURT:

/s/ David W. Craig
P. J.

## APPENDIX N

## THE SUPREME COURT OF PENNSYLVANIA
## WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

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November 20, 1991

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In Re: Armco Advanced Materials Corp., et al v. Pa. PUC, Cross Petitioner
Petition of: West Penn Power Company
Petition of: Mon Valley Energy Corp.
No. 545 W. D. Allocatur Docket 1990

Gentlemen and Ms. Ramsey:

The Court has entered the following Orders on your Petition for Allowance of Appeal, Cross-Petition for Allowance of Appeal (by Clifford Levine, Esq.), Cross-Petition for Allowance of Appeal (by Billie Ramsey) and Motion to Withdraw as Counsel (by Robert Krebs, Esq.) in the above-captioned matters:

(Petition and Cross-Petitions)
"November 19, 1991
Petition Denied
Per Curiam"

* * * *

(Motion to Withdraw as Counsel)
"November 19, 1991
Petition Granted
Per Curiam"

A Certified Copy of the Order on the Motion to Withdraw as Counsel is being sent to the Commonwealth Court.

Very truly yours,

/s/ Irma T. Gardner
IRMA T. GARDNER
Deputy Prothonotary

## APPENDIX O

## THE SUPREME COURT OF PENNSYLVANIA
## WESTERN DIVISION

CHARLES W. JOHNS, ESQUIRE
Prothonotary

IRMA T. GARDNER
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February 14, 1992

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Michael D. McDowell, Esquire
West Penn Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

In Re: Armco Advanced Materials Corporation and Allegheny Ludlum Corporation v. Pennsylvania Public Utility Commission
Petition of: West Penn Power Company
Armco Advanced Materials Corporation and Allegheny Ludlum Corporation, Petitioners v. Pennsylvania Public Utility Commission No. 545 W. D. Allocatur Docket 1990

Gentlemen:

The Court has entered the following Order on your Applications for Reconsideration of Denial of Allowance of Appeal filed in the above-captioned matters:

"PER CURIAM:

AND NOW, this 14th day of February, 1992, the Order entered on February 3, 1992 is hereby vacated. The Applications for Reconsideration filed on behalf of West Penn Power Company and Pennsylvania Public Utility Commission are denied."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

## APPENDIX P

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE SHANNOPIN MINE PROJECT

---

EMERGENCY ORDER

On April 20, 1990, Mon Valley Energy Corporation (Mon Valley), developer of the Shannopin Mine Project, a qualifying facility, filed with the Commission a motion for a stay of, or alternatively an injunction against implementation of, a "good faith deposit" requirement in its contract with West Penn Power Company (West Penn) for West Penn's purchase of electric energy and capacity. The due date for Mon Valley's deposit of $120,000 would be May 1, 1990. Mon Valley contemporaneously filed a petition for modification of the Electric Energy Purchase Agreement (EEPA), its contract with West Penn, as an exercise of this Commission's authority under both 66 Pa. C.S. § 508 and § 210 of PURPA (16 U.S.C. § 824a-3). Pursuant to the express terminology of 66 Pa. C.S. § 508, a hearing must be held before any order directing contract modification may issue.

Mon Valley's EEPA was executed on October 15, 1987, two and one-half years prior to the motion here at issue, and West Penn sought the Commission's approval of that EEPA and collection of costs from ratepayers by petition filed more than two years ago. As Mon Valley avers (Motion, pp. 2-4), it was reasonable for both it and West Penn to assume that the dates for various actions

set forth in the contract could be met after Commission action, at least as of the date the contract was executed. Subsequent to that date, however, the Commonwealth Court in *Barasch v. P.U.C.*, 546 A.2d 1296 (1988), held that in certain types of utility purchases of *capacity* from qualifying facilities, upon request of intervening opponents, hearings would be required. Since that ruling was potentially applicable to the Shannopin Project, we ordered hearings to be held and various parties appealed from our final order subsequent to those hearings. Although oral argument in those appeals occurred at the beginning of April 1990, Commonwealth Court has rendered no decision and we cannot predict when it will do so.

Mon Valley's requests for relief parallel those sought by the Burgettstown Project at Docket No. P-880284, which were previously granted. The Burgettstown Project's motion for stay of the "good faith deposit" due dates was granted in orders of Administrative Law Judge Gesoff dated June 26 and June 29, 1989, and amendment of the Burgettstown EEPA, extending the financing and related milestone dates, was granted in the Commisison order of September 29, 1989. The propriety of amendments granted in the September 29 order is an issue on appeal in the Burgettstown case, but has not previously been raised by Mon Valley. There was no appeal concerning the ALJ's extension of the "good faith deposit" due dates.

It is unlikely that the Commonwealth Court will act prior to May 1, 1990, nor can the full Commission act on Mon Valley's request since no regular Public Meeting is scheduled until after that date. Section 10.2 of Mon Valley's EEPA provides that failure to meet the deposit due dates causes automatic termination of the contract and entitles West Penn to retain all deposits previously made, plus interest. Since neither party could reasonably have envisioned the delay that has occurred, when the contract was executed, such a result would be wholly

inequitable and would unjustly enrich West Penn. Conversely, as Administrative Law Judge Gesoff noted in the June 26, 1989 *Burgettstown* Order, p. 2:

> Granting North Branch (Burgettstown developer) a stay will not prejudice WPP (West Penn) or any other party to these proceedings. If WPP's Petition (seeking approval of the EEPA) is granted, the Commission, in its final order, can direct North Branch to make the last Good Faith Payment to WPP before the Financing Closing Date . . . .

Thus granting the requested relief cannot conceivably harm any party, but instead will prevent an inequitable result. Mon Valley's property interest, the amount it has already deposited plus the amount to be deposited May 1, is unquestionably and irrevocably at risk. Thus there is a clear and present danger to this property. Since the Commission cannot grant the requested relief prior to May 1, 1990, I will issue this order as an emergency order, subject to ratification by the Commission at its next regularly scheduled Public Meeting pursuant to the provisions of 52 Pa. Code §§ 3.1-3.5.

At the Public Meeting, the Commission can entertain the motion as being a motion for a stay pending determination on the merits of the petition for modification of the EEPA, since under 66 Pa. C.S. § 508 a hearing will be required. I will also direct that any pleading in response to the *Motion for Stay* be filed by May 4, 1990, copies thereof served upon the Commissioners and Chief Counsel; THEREFORE,

IT IS ORDERED:

1. That the Mon Valley Motion for Stay of the EEPA due date for "good faith deposit" on May 1, 1990, is granted, subject to ratification by the Commission at its next Public Meeting;

2. That a copy of this emergency order be served on all parties of record with a copy served on Mon Valley,

West Penn and Allegheny Ludlum/Armco immediately; and

3. That any pleading responsive to the Motion for Stay be filed on or before May 4, 1990, copies to Commissioners and Chief Counsel.

BY:

/s/ William H. Smith
WILLIAM H. SMITH
Vice Chairman

Dated: April 27, 1990

**APPENDIX Q**

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held May 10, 1990

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.,
Commissioner
Frank Fischl,
Commissioner,
dissenting
David W. Rolka,
Commissioner

---

Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE: SHANNOPIN MINE PROJECT

---

ORDER ON MOTION OF MON VALLEY ENERGY CORPORATION FOR STAY OF GOOD FAITH DEPOSIT REQUIREMENT AND PETITION FOR MODIFICATION OF ELECTRIC ENERGY PURCHASE AGREEMENT

BY THE COMMISSION:

Before us for consideration are a petition for modification of the Electric Purchase Agreement (EEPA) previously entered by Mon Valley Energy Corporation (Mon Valley) and West Penn Power Company (West Penn), and a motion for stay of certain EEPA terms. Mon Valley filed the petition and motion concurrently on April 20,

1990. The motion for stay involved a "good faith deposit" due date of May 1, 1990. There was no scheduled public meeting at which the Commission could properly consider this motion prior to May 1, 1990. Therefore, Vice Chairman William H. Smith executed an emergency order staying the May 1, 1990 due date for the "good faith deposit", subject to ratification by the full Commission at this, its next public meeting. This order thus addresses Mon Valley's motion for stay and petition for modification.

## BACKGROUND

The petition for modification of the EEPA is the primary issue presented by Mon Valley. Mon Valley has asked for modification of the EEPA as an exercise of this Commission's authority under both 66 Pa. C.S. §508 and § 210 of PURPA (16 U.S.C. § 824a-3). However, under the express terminology of 66 Pa. C.S. § 508, there must be notice and a hearing, and any modifications ordered in a contract cannot become effective until thirty days after service of the order upon the parties to the contract. Therefore, it was impossible for any order dealing with modifications to the EEPA to be entered prior to the "good faith deposit" due dates of May 1 and July 2, 1990, unless Mon Valley had filed its petition no later than the end of January, 1990. Conversely, given the appeals of similar contract modification issues in other cases, and the appeal of the pricing provisions in the Mon Valley/West Penn EEPA, which cases had not even been briefed by January, any modification proposed then would have involved sheer speculation as to necessary time frames in the EEPA.

Mon Valley and West Penn entered into this EEPA as of October 15, 1987. On January 20, 1988, West Penn filed a petition with us requesting approval of the EEPA and a recovery of costs it would pay to Mon Valley, from ratepayers. The Commission approved West Penn's petition by tentative opinion and order entered July 9, 1988. Subsequent to that date, the Commonwealth Court in

*Barasch v. Pa. P.U.C.*, 546 A.2d 1296 (1988), held that in certain types of utility purchases of *capacity* from qualifying facilities, upon request of intervening opponents, hearings would be required. Since that ruling was potentially applicable to the Mon Valley/Shannopin Project, we ordered hearings. This proceeding was consolidated with several others involving West Penn EEPA's with qualifying facilities, and various parties appealed after our final order in the consolidated proceedings.

Mon Valley's due dates and various deadlines occur substantially later than those for the other projects for which hearings on the EEPA's were consolidated with Mon Valley. For example, the financing closing date for Mon Valley pursuant to the EEPA is December 1, 1990, while the financing closing date was October 1, 1989 for Burgettstown. Thus those projects, Milesburg and Burgettstown, requested extensions of the various due dates and other modifications in their EEPA's during the hearings held before Administrative Law Judge Gesoff. Issues related to contract modifications became what was known as "Phase II" of those proceedings. West Penn and Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny) appealed from the Commission's orders extending the financing and related milestone dates and granting other modifications in those cases. Armco/Allegheny also appealed from approval of the Mon Valley EEPA. Not knowing when Commonwealth Court would render a decision in the Mon Valley case, nor when a decision would be rendered dealing with the propriety of contract modifications for the other projects, it would have been premature for Mon Valley to request an extension of its contractual deadlines, when such might not have been necessary. However, at this point, it has become clear that a Commonwealth Court decision will not have been rendered at least in sufficient time to address the May 1 and July 2, 1990 deadline dates.

Section 10.2 of Mon Valley's EEPA provides that failure to meet the deposit due dates causes automatic termi-

nation of the contract and entitles West Penn to retain all deposits previously made, plus interest. For that reason, Mon Valley sought a stay of that provision of its EEPA by filing the motion for stay. Since the full Commission could not act on this matter prior to May 1, 1990, an emergency order was issued to stay implementation of that contractual provision until the Commission could deal with the matter. The emergency order, dated April 27, 1990, provided that any pleadings responsive to the motion for stay be filed on or before May 4, 1990. Both West Penn and Armco/Allegheny filed various pleadings with the Commission. Several of these were received only on Monday, May 7, 1990. West Penn filed with us a petition for rescission of emergency order and a reply to Mon Valley's motion for stay of good faith deposit requirements. Armco/Allegheny filed several adverse pleadings including answers to Mon Valley's motion for stay and petition for modification of its EEPA, a motion to dismiss the motion and petition of Mon Valley (all filed April 27, 1990) and a motion to rescind emergency order of the Commission.

## DISCUSSION

Armco/Allegheny filed its "motion to dismiss" allegedly pursuant to 52 Pa. Code §§ 5.101 and 5.102. Section 5.102 relates to summary judgment and judgment on the pleadings, which this motion clearly cannot be. Under § 5.101(a), a motion to dismiss has limited purposes, including being addressed to a pleading that is insufficient as to substance. Clearly a motion to dismiss is not proper here, since the pleadings of Mon Valley are sufficient in substance. It appears that the "motion to dismiss" is directed primarily to the question of the Commission's jurisdiction. We will treat this as motion questioning the jurisdiction of the Commission under § 5.101(a)(1). Armco/Allegheny claims that the Commission is deprived of jurisdiction over Mon Valley's motion for stay and

petition for EEPA modification, since Armco/Allegheny filed a petition for review of the Commission's order approving the Mon Valley EEPA in Commonwealth Court on October 28, 1989. It is true that the petition for review is still pending. However, this does not divest the Commission of jurisdiction over the matter at issue here, as we will discuss below in response to virtually the same contentions made by West Penn.

Armco/Allegheny has filed an answer to Mon Valley's motion for stay of good faith deposit requirement, as stated above. This answer opposes the stay. However, Armco/Allegheny has no interest which can be threatened by a stay of the EEPA provisions and thus has no standing to object to the stay. A party asserting standing to litigate an issue must demonstrate some actual or threatened injury to itself as a result of the other party's conduct, must show that the injury can be attributed to the other party's conduct and must show that a favorable decision will redress the injury. *Valley Forge Christian College v. Americans United For Separation of Church and State,* 454 U.S. 464 (1982). Here there is clearly no injury or potential injury to Armco/Allegheny which can result from Mon Valley continuing to have an EEPA with West Penn. Pennsylvania courts require that standing be conferred upon demonstration that the appellant has a "substantial," "direct" and "immediate" interest in the matter. *William Penn Parking Garage, Inc. v. Pittsburgh,* 464 Pa. 168, 346 A.2d 269 (1975). Thus, there must be an interest of substance in the party adversely affected; there must be a direct relationship between the activity complained of and that interest; and, the interest must be immediate and not a remote or simply potential consequence of the action. *Id.* Granting the stay will prevent an irreparable harm to Mon Valley. Conversely, the legitimate interest which Armco/Allegheny as a ratepayer has in contesting any West Penn arrangements with qualifying facilities is to insure that the prices paid to such facilities

are not in excess of those required by law. To the extent that Armco/Allegheny, or any other party, *generally* objects to qualifying facilities and believes that the termination of all utility/qualifying facility arrangements is in their interest, that is not a legitimate interest to be protected. In fact, such an interest would contravene federal laws. It is only such an impermissible interest that Armco/Allegheny may advance in contesting the grant of a stay to Mon Valley, for staying the due dates under the contract will in itself have no effect on the price for energy payable to Mon Valley. We must conclude that Armco/Allegheny has no standing to protest the grant of a stay to Mon Valley and we will not consider its answer in that regard. Of course, Armco/Allegheny is entitled to participate in any proceedings before the Commission in which matters affecting rates it may have to pay, as a West Penn ratepayer, are at issue.

West Penn also filed an answer to the motion for stay of good faith deposit, contesting a stay. West Penn asserts that the good faith deposits were a demonstration of Mon Valley's commitment to the project and that good faith deposits provide one of the strongest assurances that a project is progressing appropriately. West Penn also refers to a separate agreement with Mon Valley, a letter of July 7, 1988, attached as Exhibit A to its answer, which details certain circumstances under which a previous good faith deposit made by Mon Valley would be returnable. However, it is unclear on its face whether the letter's conditions could be met. For example, one condition is that there not be a final order of this Commission in place by the scheduled financial closing date of December 1, 1990. Presumably then if such a final order were in place by November 30, 1990, the deposit would not be returned, although it would be impossible for a financial closing to occur the next day. Given the uncertainty on the face of this letter we must conclude that the good faith deposits previously made by Mon Valley are indeed at risk, even

now, since there is not yet either a final Commission decision not subject to appeal or a Commonwealth Court decision in this matter.

West Penn asserts that "it is only Mon Valley's own failure to make the required good faith deposit" that triggers the automatic termination of the EEPA. Answer, page 4. West Penn further asserts that to the extent the motion for stay would result in modification of the EEPA, West Penn would somehow be prejudiced by the granting of the stay. In its "New Matter", West Penn submits that Mon Valley has failed to make a strong showing it would prevail on the merits of its petition for modification of the EEPA. We disagree, since as we have previously noted, that is precisely the relief this Commission granted to Burgettstown in our final order in that proceeding. West Penn again asserts that Mon Valley itself triggered the automatic termination by not making its payment and that this is not an irreparable injury since Mon Valley would have an adequate remedy at law to recover monetary damages. Surely not even West Penn believes that to be the case, since the contract by its terms, as prepared by West Penn, indicates that the deposits are automatically forfeited. Mon Valley is thus between the proverbial rock and a hard place and would have no sustainable claim for monetary damages should it make the good faith deposits but then fail to obtain final approval of the contract by the Commission.

Finally, although we do not agree with West Penn that PURPA and the FERC regulations promulgated thereunder in any way prevent modification of its EEPA with Mon Valley, the issue of modification of the contract, to grant all or some of the relief requested by Mon Valley, will be dealt with in proceedings before an administrative law judge, pursuant to the provisions of 66 Pa. C.S. § 508. As stated above, both Armco/Allegheny and West Penn have filed pleadings seeking rescission of the emergency order dated April 27, 1990. That order itself, at the

bottom of page 3, indicated that the full Commission would entertain the Mon Valley motion as being a motion for a stay pending determination on the merits of the Mon Valley petition for modification of the EEPA since a hearing would be required under § 508. Armco/Allegheny's motion for rescission appears to refer primarily to the argument, in its motion to dismiss, that the Commission lacks jurisdiction over the Mon Valley contract. The motion to rescind further discusses the definition of emergency, and whether or not an emergency order was here appropriate. However, as stated above, we find that Armco/Allegheny has no standing to contest the stay sought by Mon Valley. For that reason, we will not consider the Armco/Allegheny motion to rescind. It should be noted, however, that West Penn has raised essentially the same issues in its petition for rescission so that these arguments have been presented to the Commission.

As West Penn notes in its petition for rescission, Mon Valley by its motion sought a Commission order that would avoid the automatic termination of the EEPA between West Penn and Mon Valley, which would otherwise occur absent Mon Valley's making a $120,000 deposit by May 1, 1990. After duly noting that our regulations provide that an emergency order issued by a single Commissioner will be ratified, modified or rescinded at the next scheduled public meeting, West Penn requests that the Commission rescind the emergency order herein issued.

West Penn then advances a number of arguments as to why the emergency order should be rescinded and the Commission should decline to grant the relief sought by Mon Valley in its motion to stay. The first of these is that Pa. R.A.P. 1701 allegedly restricts the authority of the Commission to proceed here. West Penn suggests that Pa. R.A.P. 1701(a), the general rule that prohibits a governmental agency from proceeding further in a matter after review of an order has been sought, somehow pre-

vents the Commission from granting the stay here sought and from inquiring into whether the EEPA modifications should be granted. Even West Penn, however, notes the provision of Pa. R.A.P. 1701(b)(1) that an agency may "take such action as may be necessary to preserve the status quo" after an appeal. Were we to agree that in fact Mon Valley is seeking Commission action on a matter that is under appeal, which we do not, we would nonetheless be authorized to "preserve the status quo" by continuing the contractual relationship between these two parties. However, West Penn ignores the distinction that the prohibition of Rule 1701(a) is against a tribunal *modifying or reversing an order* from which an appeal has been taken. Clearly, that is not the case here—in the only proceedings involving Mon Valley, the order from which the appeal was taken approved the amounts to be paid to Mon Valley and approved West Penn's collection of those amounts from its ratepayers. It was that payment stream and the proper calculation of amounts to be paid that Armco Allegheny disagreed with and which was the basis for its appeal. Since neither Mon Valley nor any other party had previously raised the issue of due dates and other milestones in its contract, they are clearly not a part of or germane to any order on appeal.

It is also untrue, as West Penn contends, that allowing a new occurrence (i.e., the automatic termination of the EEPA) would *preserve* the status quo rather than altering it. It is clear that the automatic termination of the agreement would change the previously existing relationship between West Penn and Mon Valley. Therefore, it is equally clear that preserving the status quo requires preserving that contractual relationship. Finally, Pa. R.A.P. 1701(c) provides that where only "a particular item, claim or assessment" is involved in an appeal, the government agency may proceed further with unrelated matters unless the appellate court were to order otherwise. Thus even if the question of the due dates were considered

somehow related to the appeal previously taken, a position with which we disagree, the provisions of Pa. R.A.P. 1701(c) would allow the Commission to proceed in the matters here at issue. Common sense also dictates that it is the Commission, not Commonwealth Court, which is the proper forum to determine whether a stay should be granted and whether the requested contract modifications should be made. Commonwealth Court could not deal with such issues without exercising its original jurisdiction. Clearly, this was not the intent of the prohibitions in Rule 1701.

West Penn next reasserts its argument that sales for resale are under the exclusive jurisdiction of FERC and that PURPA limits the Commission's power to act, rather than expanding it. We reject the notion that PURPA's express grant of power to the Commission to implement the FERC regulations fails to include the power to prescribe provisions in contractual arrangements between qualifying facilities and utilities. Indeed, the whole purpose of PURPA was to empower the state commissions to require utilities to enter into arrangements for the purchase of electric energy and capacity from qualifying facilities under terms and conditions that would encourage the development of such facilities. It is absurd to contend that the Commission can direct a utility to make a purchase but cannot direct modifications to an agreement which will allow that purchase to go forward. While as we have stated before, we are in favor of freely negotiated contracts between utilities and qualifying facilities, we recognize that such agreements normally contain provisions far stricter than assurances the utility itself would make to ratepayers, when embarking upon its own construction program. It is our position that we indeed have the power to mandate changes necessary to ensure that such projects are not unfairly terminated particularly when, as here, circumstances wholly beyond the control of the project have operated to cause unexpected delay. As a further note, however, it is not true that the emergency order amended or revised the EEPA. Whether the

EEPA is to be revised will be the subject of such hearings as may be necessary pursuant to 66 Pa. C.S. § 508. The emergency order and the order we enter here today simply grant Mon Valley's motion to stay that would otherwise be automatic termination of the EEPA, pending resolution of the proposed amendments. West Penn seems confused on this point, somehow believing that the Commission has failed to comply with 66 Pa. C.S. § 508 —we will, in fact, by this order direct that an investigation be undertaken pursuant to 66 Pa. C.S. § 508.

As it did in its reply to Mon Valley's motion for stay, West Penn in its motion to rescind also asserts that Mon Valley is unlikely "to prevail on the merits" and that Mon Valley would have an adequate remedy at law to recover the good faith deposits, so that there is no "irreparable injury." What may normally be a proper refusal to grant a stay when only monetary losses are involved cannot be justified here, since these monetary losses will be unrecoverable. It is not simply a question of damages which can later be returned to Mon Valley—here, West Penn has made it patently clear that it intends to exercise the provisions of the contract which allow it to retain all "good faith deposits" plus interest, even though West Penn itself has suffered no loss.

West Penn's next argument is that allegations of the Mon Valley motion to stay would not support issuance of an emergency order. As support for that position, West Penn quotes at length from a Commission order entered in the *Milesburg* case at Docket Nos. P-870216, on March 31, 1989. That Commission order, in turn, cited *Peoples Natural Gas Co. v. Pa. P.U.C.*, at No. 1898 C.D. 1988, as support for failure to grant an emergency order. The first point that should be noted is that the *Peoples* case involved *speculative* economic threat of loss, which is not the case here. Here, unlike most cases where monetary damages are at issue, there is unquestionably a clear and present risk of Mon Valley's losing any good faith deposits. In other words, Mon Valley cannot

sue to recover these amounts but will automatically face this loss.

Second, as the Commission noted in the *Milesburg* order entered March 31, 1989, the Commission could not modify the contract until after reasonable notice and hearing, pursuant to 66 Pa. C.S. § 508. In other words, the emergency relief requested in that instance involved the actual changing of the contract as opposed to the instant case wherein Mon Valley has sought only a stay pending a Section 508 determination of contract modification.

Third, and perhaps most compelling, in the March 31, 1989 order the Petitioner had sought relief *after* the passage of the operative date, so that any "emergency" by definition could not have existed, i.e., since the date of performance had already passed, there was no need for an emergency order instead of a final resolution of the issue of contract modification. It is disingenuous for West Penn to assert that Mon Valley could avoid an "emergency" by merely paying the good faith deposit. Mon Valley could avoid the automatic termination of the contract by paying the good faith deposit but would then risk losing the good faith deposit as well as money it had previously paid. It is the irretrievable loss of the funds, as well as the contract, which presented Mon Valley an unresolvable conflict—it could risk losing more money, in the face of uncertainty as to whether there will ever be a final, non-appealable Commission order in this case, or it could risk the automatic termination of the contract by failing to make good faith deposits without a Commission order preserving the contract status until resolution of Mon Valley's request for extension of the contract dates.

Although Mon Valley could have acted sooner than it did, even at this date any time frame for Commonwealth Court action or actions under the contract between West Penn and Mon Valley is speculative at best. Thus we can appreciate the dilemma in which Mon Valley found itself

and we will find, in spite of the fact that the May 1, 1990 deadline was obvious, that Mon Valley should not be deprived of preservation of its contractual relationship with West Penn, pending resolution of both its petition for modification and the resolution of the Commonwealth Court appeal. Thus we ratify and modify the previous emergency order, by granting a stay of the "good faith deposit" due dates and a stay of the "automatic" termination provisions of the EEPA. We also will direct consideration of the petition for modification of the EEPA; THEREFORE,

IT IS ORDERED:

1. That the Mon Valley Energy Corporation motion for stay is granted and the automatic termination as provided in Section 10.2 of the EEPA, if the due dates of May 1 and July 2, 1990 for "good faith deposits" are not met, is stayed.

2. That the modification proposed in the petition for modification of the EEPA shall be considered, along with the answers of West Penn Power Company and Armco/Allegheny, in such hearings as may be necessary, and that this matter is assigned to the Office of Administrative Law Judge.

3. That the motions for rescission of emergency order, filed by West Penn and Armco/Allegheny are denied, consistent with this Order.

4. That the motion to dismiss filed by Armco/Allegheny is denied, consistent herewith.

5. That a copy of this order be served on all parties to this proceeding.

BY THE COMMISSION:

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: May 10, 1990

ORDER ENTERED: May 10, 1990

## APPENDIX R

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Docket No. P-880186

IN THE MATTER OF THE PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT: RE: SHANNOPIN MINE PROJECT

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### SECOND PRE-HEARING ORDER

Mon Valley Energy Corporation (Mon Valley) has filed a Motion to Strike Portions of West Penn's Direct Testimony or, Alternatively, to Dismiss West Penn's Objections to Interrogatories and Request for Production (Second Set) (hereinafter referred to as Motion to Strike). Also, North Branch Energy Partners, L.P. (North Branch) has filed a Petition to Intervene (Petition). This order disposes of these pleadings and in doing so sets the scope of the hearings which will begin on January 28, 1991.

Mon Valley claims that portions of West Penn's prefiled testimony are irrelevant to this proceeding. The testimony in question is contained in West Penn's prefiled testimoy. It concerns West Penns' capacity needs as of October 15, 1987, the date the Mon Valley EEPA was signed, and West Penn's current avoided costs. Mon Valley argues that this testimony is irrelevant because its Petition to Modify the EEPA does not request a recalculation of West Penn's avoided costs, but, rather, seeks, *inter alia*, extension of milestone dates and a capacity rate modification to reflect a later commencement date. Mon Valley adds that it seeks to lessen West Penn's dis-

count of the avoided cost figure to reflect a later in-service date.

Mon Valley relies on two Commonwealth Court decisions. The first directed the Commission to recalculate West Penn's avoided costs using input as of October 15, 1987, and according to the method of calculation used by West Penn during Phase I of these proceedings. *Armco Advanced Materials Corporation, et al. v. Pennsylvania Public Utility Commission*, (No. 2091 C.D. 1989, filed July 17, 1990) (*Shannopin*). The second held that the Commisison has the authority to modify EEPA's to ensure that litigation delays do not determine if a project suceeds or fails and to ensure that the purposes of the Public Utility Regulatory Policies Act (PURPA) are fulfilled. *Armco Advanced Materials Corporation, et al. v. Pennsylvania Public Utility Commission*, —— Pa. Commw. ——, 579 A. 2d 1337, at 1350 (1980). Mon Valley argues that by finding the operative date for determining avoided costs to be the date of contract signing, Commonwealth Court also recognized that the modifications allowed did not create new contracts.

The Commission has not recalculated West Penn's avoided costs pursuant to the Commonwealth Court mandate, most likely because *Shannopin* is the subject of three appeals or cross-appeals to the Pennsylvania Supreme Court by the Commission, West Penn and Mon Valley. 545 W.D. Allocator Docket 1990. The avoided costs ultimately determined as a result of the Phase I proceedings will determine the rates to be received by Mon Valley.

While the appeals to the Supreme Court are pending, however, the Commission has no jurisdiction over Phase I matters such as avoided costs. Rule 1701(b) of the Pennsylvania Rules of Appellate Procedure, 42 Pa. C.S. § 1701(b). This is why the Commission has not recalculated West Penn's avoided costs and is why Mon Valley's Motion to Strike should be granted. The Motion

to Strike is premature, however, because West Penn has not yet offered the testimony into the record. When presented at the hearing, the Motion will be granted.

The Motion to Strike would be granted absent the Supreme Court appeals, however. Modification of the EEPA does not create a new contract for the reasons enunciated by Mon Valley in its Motion to Strike. Mon Valley's petition to modify the EEPA does not request a redetermination of West Penn's avoided costs and this proceeding should not and will not be turned in to a rate hearing. Instead, the currently scheduled hearings in this proceeding are limited to exploring whether the requested modifications to the EEPA are appropriate. These modifications have been clarified and updated by Mon Valley's recently filed Supplement to the Petition and the supplemental testimony of Mon Valley witnesses Buras and Irving.

It is not necessary to dismiss West Penn's objections to Mon Valey's Interrogatories (Second Set) 1, 2 and 3 because they relate to information regarding its avoided costs, an issue not under litigation in this proceeding. West Penn, therefore, need not answer those interrogatories and Mon Valley's motion to dismiss them shall be denied.

North Branch argues that it should be allowed to intervene as a party because any determination of West Penn's need for capacity in October 1987 may have an effect on its capacity rate calculation as of October 1987, as related to its EEPA with West Penn, also dated as of October 15, 1987. West Penn's capacity needs are not at issue in this proceeding for the reasons given above. Also, the West Penn testimony about which North Branch is concerned will be stricken at the hearing. North Branch, therefore, has advanced no reason why it is eligible to intervene pursuant to the Commission's regulations governing intervention set forth at 52 Pa. Code § 5.72 et seq. For this reason, North Branch's Petition will be denied.

This order is issued before West Penn has had the opportunity to file an answer to the Motion to Strike and before the parties have had the opportunity to file answers to North Branch's Petition. Such action does not prejudice any party because the Commission's lack of jurisdiction dictates the action taken here regardless of what the answers would contain. Also, taking this action now gives the parties earlier notice of the scope of the hearings and, therefore, gives them more time to prepare for litigation.

AND NOW, for the above reasons, it is ordered:

1. That the Motion to Strike filed by Mon Valley Energy Corporation is denied as premature.

2. That the Motion to Dismiss West Penn's Objections to Interrogatories and Request for Production (Second Set) filed by Mon Valley Energy Corporation is denied.

3. That the Petition to Intervene filed by North Branch Energy Partners, L.P. is denied.

4. That the scope of the hearings in this proceeding is limited to the appropriateness of the modifications to the EEPA requested by Mon Valley Energy Corporation as originally requested and as clarified and updated by Mon Valley's recently filed Supplement to the Petition and the supplemental testimony of Mon Valley witnesses Buras and Irving.

Dated: January 9, 1991

/s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

**APPENDIX S**

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT: RE: SHANNOPIN MINE PROJECT

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RECOMMENDED DECISION

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Before
Larry Gesoff
Administrative Law Judge

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## I. BACKGROUND

In February, 1986, Mon Valley Energy Corporation (Mon Valley) initiated negotiations with West Penn Power Company (West Penn) for the sale of electric energy from a proposed 80 MW coal-fired facility to be located in Greene County, Pennsylvania. The parties entered into an Electric Energy Purchase Agreement (EEPA), dated as of October 15, 1987. MV Ex. 1. A condition in the EEPA requires Commission approval of the capacity cost rate which will be passed through to West Penn's ratepayers. On January 20, 1988, West Penn filed with the Commission a petition requesting an order approving the term of the Mon Valley EEPA under the Public Utilities Regulatory Policies Act of 1978 (PURPA), 18 C.F.R. 292.205(a) and 206, and the Pennsylvania Public Utility Code, 66 Pa. C.S. § 101 et seq., and authorizing West Penn to pass its costs under the EEPA to its ratepayers. Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), two industrial customers of West Penn, intervened in the action to oppose the capacity rate contained in the Mon Valley EEPA.

The Commission tentatively approved the Mon Valley EEPA, but before a final order could be issued, the Pennsylvania Commonwealth Court issued its decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commw. 81, 546 A.2d 1296 (1988) (*Milesburg I*). The court held in *Milesburg I* that ratepayers were entitled to an administrative hearing on the reasonableness of capacity rates. As a result, the Commission consolidated the Mon Valley proceeding with those involving other similar cogeneration projects (including those known as the Milesburg Project and the Burgettstown Project). All three projects had entered into EEPAs with West Penn at rates based on West Penn's avoided costs, as calculated and adjusted by West Penn. All three projects participated in

the newly-required hearings to determine the validity of the rate calculations.

The undersigned conducted the hearings in April 1989, dividing the proceeding into two phases. Phase I addressed the rate aspects of the consolidated proceedings. Phase II addressed the Petitions for Modification that had been filed by Burgettstown and Milesburg pursuant to Section 508 of the Public Utility Code, 66 Pa. C.S. § 508. Mon Valley was involved in Phase I of the April 1989 hearings because the commencement date for its project was substantially later than those of the other projects.

The Recommended Decision for Phase I held that the rates in the various EEPAs, calculated by West Penn as of the "time of serious negotiations" of the contracts, were just and reasonable. For Phase II, the undersigned recommended that the requests for modification be denied. The Commission approved the Phase I recommendations by decision dated September 29. 1989. *In Re: West Penn Power Company*, 106 PUR 4th 459 (1989). In Phase II, the Commission found that modification of the Burgettstown and Milesburg EEPAs was proper.

Separate appeals of the three actions were filed with the Commonwealth Court with respect to both Phase I and Phase II of the Commission's decision. In mid-1990, the Commonwealth Court issued three separate opinions. *Armco Advanced Materials Corporation, et uno v. Pennsylvania Public Utility Commission*,—— Pa. Commw. ——, 579 A.2d 1337 (1990) (*Milesburg II*), *Armco Advanced Materials Corporation, et uno v. Pennsylvania Public Utility Commission*, (Nos. 2090 and 2097 C.D. 1989, filed September 7, 1990) (*Burgettstown*) and *Armco Advanced Materials Corporation, et uno v. Pennsylvania Public Utility Commission*, (No. 2092 C.D. 1989, filed July 17, 1990) (*Shannopin*).

In *Milesburg II*, the Commonwealth held that it was appropriate to modify contracts to conform with PURPA.

In the context of Phase I, the court held that the appropriate time for determining the avoided capacity rate was the time the parties had established a "legally enforceable obligation" for the sale of energy. The Court found that a legally enforceable obligation existed as of the time the parties executed a contract. This holding dictates the outcome in *Shannopin*.

With respect to Phase II, the Court held in *Milesburg II* that "[a] utility's submission of its contract with a QF to the PUC for approval is legally equivalent to a petition by the QF to enter into that contract." —— Pa. Commw. at ——, 579 A.2d at 1348.

The Commonwealth Court remanded all three actions to the Commission for recalculation of the capacity rates contained in the EEPAs on the basis of its decision. Petitions for Allowance of Appeal are currently pending before the Pennsylvania Supreme Court in all three actions.

## II. HISTORY OF THE PROCEEDING

On April 20, 1990, before entry of the Commonwealth Court's Order in Phase I, Mon Valley filed a Petition for Modification of an Electric Energy Purchase Agreement (Petition for Modification). On the same date, Mon Valley filed a Motion for Stay of Good Faith Deposit Requirement of Electric Energy Purchase Agreement or Alternatively, Motion to Enjoin West Penn from Implementing Section 6.2 of the EEPA (Motion for Stay).

On April 27, 1990, the Commissioner (now, Chairman) William H. Smith issued an Emergency Order granting the stay of May 1, 1990 good faith deposit. By order dated May 10, 1990, the Commission ratified the stay of the good faith deposit pending the outcome of these proceedings. This prevented the automatic termination of the Mon Valley EEPA. The Commission found that it had jurisdiction over Mon Valley's petition for Modification because Mon Valley had participated only in Phase I of

the earlier hearings. It directed the petition to the Office of Administrative Law Judge for hearings on the proposed modifications.

A pre-hearing conference took place on August 10, 1990. Pursuant to the first pre-hearing order issued by the undersigned, Mon Valley filed direct testimony on October 1, 1990. On January 8, 1991, Mon Valley filed a Supplement to its Petition for Modification. On January 10, 1991, the undersigned issued a second pre-hearing order limiting the scope of the proceeding to the reasonableness of the modifications as originally requested by Mon Valley and as clarified and updated by the Supplement to the Petition and the supplemental testimony of Mon Valley witnesses Buras and Irving. The order also held that all rate issues fell within Phase I of the proceedings and would not be heard in Phase II.

The Phase II hearing began on January 28, 1991 and ended on January 30, 1991. Numerous witnesses testified and many statements of direct testimony and exhibits were admitted into the record. Owing to the second prehearing order defining the scope of the proceeding, the undersigned struck approximately twenty-one pages and six exhibits from the direct testimony of West Penn witness Binder; approximately four pages from the supplemental direct testimony of Mr. Binder; and the direct testimony of West Penn witness Kave. Tr. 293-297, 368-369. The record consists of these statements and exhibits and a 422 page transcription of the notes of testimony. All parties filed Main and Reply Briefs, except for the Office of Consumer Advocate (OCA) which filed a Main Brief only.

## III. THE MON VALLEY PROJECT

Mon Valley is the developer of the Shannopin Mine Project (Shannopin Project or Project), which in its Main Brief (MB) Mon Valley states is a "qualifying small power production facility" (QF) within the meaning of PURPA. As noted, the Project has been designed as an 80 MW

(net) cogeneration facility which will burn run-of-mine bituminous coal and will be located in Greene County, Pennsylvania, adjacent to a coal mine owned and operated by Shannopin Mining Company (Shannopin). The facility will simultaneously produce electricity which West Penn agreed to purchase, and steam which Shannopin will purchase for drying coal in its wash facility. The steam will improve the drying capabilities of the coal preparation facility. MV S-3 at 3; Tr. 109, 122-124. Drying the coal will increase its BTU content, making its more attractive to potential customers and Shannopin more competitive in the coal market. The facility will require up to 360,000 tons of coal annuually over the 30 year term of the contract. MV S-3 at 3.

## IV. REQUESTED RELIEF

In its original Petition filed April 20, 1990, Mon Valley set forth a proposed schedule for modifications. It also requested any other modification that is just and equitable. Because of the continuing delays, Mon Valley filed its Supplement to the Petition proposing modifications to the EEPA consistent with the relief requested in the Supplement. The following chart from page 15 of Mon Valley's Main Brief sets forth the requested modifications:

| | Contract Provision | EEPA | Requested Modification |
|---|---|---|---|
| 1. | Financing Closing Date Deadline | 12/01/90 | 12/01/92 or six (6) months after non-appealable order, whichever is later |
| 2. | Earliest Interconnection Date | 03/01/92 | 03/01/94 or twenty-one (21) months after non-appealable order, whichever is later |
| 3. | Earliest Commencement Date | 09/01/92 | 09/01/94 or twenty-seven (27) months after non-appealable order, whichever is later |
| 4. | Dates on which monthly payments are required due to a late Commencement Date | 09/01/93 and 09/01/94 | 09/01/95 and 12/01/95 or thirty-nine (39) and forty-two (42) months after non-appealable order, whichever is later |

| | Contract Provision | EEPA | Requested Modification |
|---|---|---|---|
| 5. | Latest Commencement Date | 03/01/95 | 03/01/96 or forty-five (45) months after non-appealable order, whichever is later |
| 6. | Good Faith Deposit Dates | 05/01/90 07/02/90 and 10/01/90 | 05/01/92, 07/02/92, and 10/01/92 or one (1), three (3) and five (5) months after non-appealable order, whichever is later |
| 7. | Project in-service date used as basis for capacity rate | 09/01/92 | 09/01/94 or twenty-seven (27) months after non-appealable order, whichever is later |
| 8. | Financing term | Up to 15 years | Up to 25 years |
| 9. | Change in boiler | Circulating Fluidized Bed | Pulverized coal boiler and dry scrubber boiler |

To prevent future modification proceedings, Mon Valley requested that the Commission grant any additional relief that is just and equitable.

## V. FINDINGS OF FACT

(No party objected to the proposed findings of fact offered by Mon Valley. The Findings of Fact set forth below, as amended, are taken from those offered by Mon Valley.)

1. Mon Valley began negotiations with West Penn for the sale of electric energy in February, 1986.

2. Mon Valley and West Penn entered into an Electric Energy Purchase Agreement, dated as of October 15, 1987.

3. On January 20, 1988, West Penn filed with the Commission a Petition requesting an order approving the terms of the Mon Valley EEPA.

4. Armco/Allegheny, two industrial customers of West Penn, intervened in the approval process to oppose the capacity rate contained in the Mon Valley EEPA.

5. The Commission tentatively approved the Mon Valley EEPA by entry of a Tentative Opinion and Order on July 8, 1988.

6. The Commonwealth Court decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commw. 81, 546 A.2d 1296, *reargument denied*, 119 Pa. Commw. 115, 550 A.2d 257 (1988) (*Milesburg I*) was the first Pennsylvania appellate decision to state that ratepayers were entitled to an administrative hearing on the reasonableness of capacity rates.

7. Because of the Commonwealth Court's holding in *Milesburg I*, the Commission consolidated the Mon Valley EEPA approval proceeding with those involving other similar cogeneration projects, including the Milesburg and Burgettstown Projects, for hearings on, among other issues, the reasonableness of the capacity rates contained in the various EEPAs.

8. Hearings took place in April, 1989.

9. The hearings were divided into Phase I which addressed the rate issues and Phase II which addressed the modification petitions filed by the other projects.

10. Mon Valley participated only in Phase I of the April, 1989, hearings.

11. The Commission approved the Mon Valley EEPA by Order dated September 29, 1989.

12. Armco/Allegheny appealed the Commission's Order to the Pennsylvania Commonwealth Court.

13. By Order dated July 17, 1990, the Commonwealth Court modified the Commission's approval of the Mon Valley EEPA and directed the Commission to recalculate the capacity rate.

14. By Order dated July 17, 1990, the Commonwealth Court held in the Milesburg proceeding that the Commission had the authority to order the parties to

enter into a new contract with the appropriate modifications as requested in Phase II.

15. By Order dated September 7, 1990, the Commonwealth Court held in the Burgettstown proceeding that the Commission had the authority to order the appropriate modifications as requested in Phase II.

16. West Penn filed a Petition for Allowance of Appeal of the Commonwealth Court's order in the Mon Valley proceeding with the Pennsylvania Supreme Court on October 15, 1990.

17. The Shannopin Project will provide useful thermal energy in the form of low pressure steam to an independent business. MV Ex. 24; MV S-2 at 2-4; MV S-3 at 2.

18. At least 5% of the total energy output of the Shannopin facility will be sold to an independent business. MV Ex. 24; MV S-2 at 2-4.

19. The ownership structure of the Shannopin Project does not contemplate that an electric utility, affiliate of an electric utility, or combination of the utilities or utility affiliates will own more than 50% of the equity of the project. MV Ex. 24; MV S-2 at 2-4.

20. The Shannopin cogeneration facility will use bituminous coal, mined in Pennsylvania. MV S-2 at 5; MV S-3 at 3.

21. The Shannopin Project will increase employment in an economically depressed county by providing 350 to 450 construction jobs and 35 to 40 permanent jobs and will help secure the 250 existing mining jobs at the Shannopin Mine. MV S-1; MV S-2 at 18; MV S-3 at 4.

22. Mon Valley has completed contractual, engineering, and permitting work related to the EEPA. MV S-1, S-2, S-6, S-6A, S-7, S-7A.

23. Mon Valley has spent amounts of money related to the EEPA.

24. Extension of the milestone dates contained in the Mon Valley EEPA will prevent the automatic termination of the contract.

25. The extension of the earliest in-service date and the use of that date as the basis for determining the capacity rate will not change West Penn's avoided costs. MV S-6 at 21.

26. Use of a pulverized coal boiler with a scrubber will benefit the project by expediting the construction schedule for the facility. Tr. 251-2.

27. Use of a pulverized coal boiler with a scrubber will have no adverse effect on West Penn or its ratepayers. MV S-7A at 3-4; Tr. 260-1; WP S-6 at 33; Tr. 275-6.

28. The extension of the financing term in the EEPA will benefit the Shannopin Project by reducing the initial principal and interest payments to be paid by Mon Valley. Tr. 144.

29. The extension of the financing term to a term not exceeding 25 years will have no unreasonable adverse impact on West Penn or its ratepayers.

30. Assignment of the Mon Valley EEPA to Mon Valley Energy Limited Partnership, having as its general partners Mon Valley Energy Corporation and CMS Generation Mon Valley Co., a wholly owned subsidiary of CMS Generation, will benefit the project by enhancing the ability of the project to obtain financing.

31. Assignment of the Mon Valley EEPA to Mon Valley Energy Limited Partnership will have no adverse effect on West Penn or its ratepayers.

32. The later in-service date requested by Mon Valley will not adversely affect West Penn's generation planning. MV Ex. 39; Tr. 397.

33. The in-service date contemplated for the Shannopin Project in West Penn's Integrated Resource Plan, dated April 16, 1990, is September, 1994. MV Ex. 39.

34. West Penn's Integrated Resource Plan, dated April 16, 1990, includes 82 MW of new PURPA generation. MV Ex. 39.

35. The Shannopin Project represents 80 MW of the 82 MW of new PURPA generation capacity included in West Penn's Integrated Resource Plan, dated April 16, 1990. MV Ex. 39.

36. West Penn's planning alternative to PURPA projects is reactivation of four of its Mitchell and Springdale units, all of which are oil-fired units and have been in inactive reserve for approximately two years. MV Ex. 39; Tr. 389.

## VI. DISCUSSION

### A. *Jurisdiction.*

At page 52 of its Main Brief, Armco/Allegheny revive an allegation that the Commission lacks jurisdiction to consider the Petition to Modify owing to pending court appeals. Armco/Allegheny does so by incorporating into its Main Brief by reference the arguments it made in a pleading filed April 27, 1990, which the Commission characterized and treated as a Motion to Dismiss the Petition. The Commission ruled that Armco/Allegheny had no standing to challenge the stay in its Order on Motion of Mon Valley Energy Corporation for Stay of Good Faith Deposit Requirement and Petition for Modification of Electric Energy Purchase Agreement, entered May 10, 1990 (May 10 Order). The jurisdictional issue was discussed, however, because West Penn raised it in its petition to rescind the emergency order granting the stay.

Rejecting the assertion that the Commission lacks jurisdiction, the Commission stated as follows at pages 10 and 11 of its May 10 Order:

West Penn then advances a number of arguments as to why the emergency order should be rescinded and the Commission should decline to grant the relief sought by Mon Valley in its motion to stay. The first of these is that Pa. R.A.P. 1701 allegedly restricts the authority of the Commission to proceed here. West Penn suggests that Pa. R.A.P. 1701(a), the general rule that prohibits a governmental agency from proceeding further in a matter after review of an order has been sought, somehow prevents the Commission from granting the stay here sought and from inquiring into whether the EEPA modifications should be granted. Even West Penn, however, notes the provision of Pa. R.A.P. 1701(b)(1) that an agency may "take such action as may be necessary to preserve the status quo" after an appeal. Were we to agree that in fact Mon Valley is seeking Commission action on a matter that is under appeal, which we do not, we would nonetheless be authorized to "preserve the status quo" by continuing the contractual relationship between these two parties. However, West Penn ignores the distinction that the prohibition of Rule 1701(a) is against a tribunal *modifying or reversing an order* from which an appeal has been taken. Clearly, that is not the case here—in the only proceedings involving Mon Valley, the order from which the appeal was taken approved the amounts to be paid to Mon Valley and approved West Penn's collection of those amounts from its ratepayers. It was that payment stream and the proper calculation of amounts to be paid that Armco/Allegheny disagreed with and which was the basis for its appeal. Since neither Mon Valley nor any other party had previously raised the issue of due dates and other milestones in its contract, they are clearly not a part of or germane to any order on appeal. (Emphasis in original)

The Commission's sound reasoning applies here. Clearly, the Commission has the jurisdiction to hear and dispose of Mon Valley's Petition to Modify.

B. *Burden of Proof.*

Section 332(a) of the Public Utility Code, 66 Pa. C.S. § 332(a), provides that "the proponent of a rule or order has the burden of proof." By requesting that the Commission modify the EEPA, Mon Valley has the burden of proof and must establish that modification is just and reasonable and within the PURPA regulations.

C. *PURPA v. Section 508.*

1. Mon Valley.

Relying on *Milesburg II* and *Burgettstown*, Mon Valley asserts that the Commission may modify any contract submitted to it for approval to ensure that the contract complies with FERC regulations and the goals of PURPA. MV Main Brief (MB) at 19-21. At pages 48 and 49 of its Main Brief, however, Mon Valley asserts that Section 508 of the Public Utility Code, 66 Pa. C.S. § 508 authorizes the Commission to modify contracts in a manner that is fair, reasonable and in the public interest.

2. West Penn.

At pages 15 and 16 of its Main Brief, West Penn argues that Section 508 does not apply to this modification proceeding, the Commission and the Commonwealth Court having resolved this issue in favor of PURPA.

3. OCA.

OCA submits that the Commission must review Mon Valley's request using the PURPA regulations and being guided by Commission requirements. The Commission, therefore, must determine that the modifications result in

a contract which is just, reasonable, equitable and in the public interest.

4. Recommendation.

Section 210 of PURPA creates an obligation for electric utilities to purchase power from QFs and small power producers. 16 U.S.C. § 824a-3. The standard for review is set forth in the statute and regulations:

> (b) Rates for purchases by electric utilities
>
> The rules prescribed under subsection (a) of this section shall insure that in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

16 U.S.C. § 24a-3(b) and 18 C.F.R. § 292.304 (a).

Section 508 provides the Commission with the power and authority to:

> vary, reform, or revise, upon a fair, reasonable, and equitable basis, any obligations, terms, or conditions of any contract heretofore or hereafter entered into between any public utility and any person, corporation, or municipal corporation, which affect or concern a public right, benefit, privilege, duty, or franchise, or the grant thereof, or are otherwise affected or concerned with the public interest and the general well-being of this Commonwealth.

Section 508 further provides that the Commission may modify any obligations, terms or conditions of a contract

that are unjust, unreasonable, inequitable, or otherwise contrary to the public interest and general well-being of this Commonwealth.

In *Milesburg II*, the Commonwealth Court observed as follows:

> A utility's submission of its contract with a QF to the PUC for approval is legally equivalent to a petition by the QF to the PUC to compel the utility to enter into that contract. In our view, such a petition necessarily invokes the full power and duty of the PUC to examine all of the contract's terms and conditions to ensure that they are in compliance with the FERC regulations implementing PURPA. This principle applies to terms relating to milestone dates as well as terms relating to price. The situation is not significantly different from one where a QF simply petitions the PUC to compel a utility to purchase. The PUC must order a rate for such a purchase equivalent to the full avoided costs, 18 C.F.R. § 292.304(b)(2), and the PUC may not order terms or conditions for the purchase in any way contrary to the FERC regulations, or contrary to the goals of PURPA.
>
> * * * *
>
> As the PUC's opinion indicates, the power it exercised was its federally delegated power under PURPA. That power is different from the PUC's power under the state Public Utility Code, and it is not constrained by the provisions of state law.

579 A.2d at 1348-49.

West Penn is correct. The Commission's power to modify the EEPA has been delegated to it from the FERC and does not come from Section 508. *See*, 18 CFR § 292.401(a) (Implementation by State regulatory authorities). Section 508 is not controlling in this proceeding.

D. *Do the Regulatory Litigation Delays that Justified Modification of the Milesburg and Burgettstown EEPAs Justify Modification of the Mon Valley EEPA.*

1. Mon Valley. (MB at 19-21)

In *Burgettstown,* the automatic termination provisions of the EEPA were stayed to prevent the contract from lapsing. The Commission modified the existing EEPA to provide for a financing closing date six months from the entry date of a non-appealable order, with appropriate extensions to related milestone dates. 106 PUR 4th at 478. The Commonwealth Court held that the Commission properly exercised its authority to order these modifications of the contract. *Burgettstown,* at 20.

The Commonwealth Court recognized that regulatory litigation prevented the timely development of the Milesburg and Burgettstown projects. Because of the delays, it was incumbent upon the Commission to modify the EEPAs to save the projects. The court's decisions in *Milesburg II* and *Burgettstown* clearly control the proceedings at hand. The same litigation delayed development of the Shannopin Project. The Mon Valley EEPA was submitted to the Commission for approval at the same time as the Burgettstown EEPA. Mon Valley was compelled to participate in the same rate hearings. Like the other actions, the Mon Valley proceeding was appealed to the Commonwealth Court. Review of Mon Valley's Phase I proceedings is now pending before the Pennsylvania Supreme Court.

These continuing delays have made it impossible for Mon Valley to meet the EEPA milestone dates. It has been impossible, therefore, for Mon Valley to achieve financing closing and proceed to the construction phase under the milestone schedule set forth in the EEPA. Like the Milesburg and Burgettstown projects, Mon Valley requested a stay of those provisions and petitioned for the necessary

modifications so that its project could survive and continue to develop as originally anticipated. The same regulatory litigation delays that justified modification of the Milesburg and Burgettstown EEPAs justify modification of the Mon Valley EEPA.

2. West Penn. (Reply Brief (RB) at 2-6)

West Penn denies that the requested contract modifications are "mandated" because of the Commonwealth Court's statement in *Milesburg II* that the Commission "may modify other provisions of the contract if it concludes that they are not in accordance with PURPA and the FERC regulations." 579 A.2d at 1339.

The Shannopin Project has experienced litigation delay almost as severe as the other two projects, but litigation delay is not sufficient reason in itself to warrant the granting of the requested modifications. With the requested modifications, the Shannopin Project is not an "otherwise acceptable and desirable project" and, on the merits of this case, the Commission should find that Mon Valley did *not* carry its burden of proving that the requested contract modifications are just and reasonable to West Penn's customers and the public interest.

The circumstances and timing surrounding the requested contract modifications are different than those before the Commission in the Phase II proceedings on the Milesburg and Burgettstown projects in the following respects:

—At the time the Commission ordered modified contracts for the Milesburg and Burgettstown Projects, it also approved the capacity rates for the projects (although the rates were later appealed to the Commonwealth Court). The capacity rates for the Shannopin Project are not known at this time because they are pending appellate court action. West Penn submits that the Commission should not grant the requested contract modifications without knowing what the avoided costs are.

—Mon Valley requests a recalculated capacity rate based on a later in-service date for the Shannopin Project. Although this same request was made for the Milesburg Project, but not for the Burgettstown Project, West Penn maintains that such a recalculation changes avoided capacity costs which is a subject beyond the jurisdiction of the Commission at this time because it is an issue pending appellate court action.

—Unlike the other projects, Mon Valley requests a change in technology for the Shannopin Project. This has littled to do with delays caused by litigation.

—Unlike the other projects, Mon Valley requests a change in the financing terms in the EEPA. This request has nothing to do with litigation delays. As explained in West Penn's main brief, this request, if granted, would reduce the value of West Penn's security interest in the project and, thus, would provide less protection for West Penn and its customers.

—Unlike the other projects, Mon Valley requests a change in the ownership of the Shannopin project. This request of the Commission first surfaced in Mon Valley's main brief. Before forming an opinion on this request, West Penn would like to exercise its right under the EEPA to review the specific documents to be used to accomplish the ownership change. To date, Mon Valley, despite its obligation under the EEPA, has not furnished West Penn with the documentation. Mon Valley's request is late in the context of the hearing process, but at the same time, is premature in the context of rational contractual administration of PURPA projects.

—The hearing on the Shannopin contract modification follows the Milesburg and Burgettstown contract modification hearing by almost two years although all three projects were projected to delay the construction of the same base-load, coal-fired generating plant. All three projects are pending further appellate court action. West Penn submits that the passage of time and the uncertainty of the Milesburg and Burgettstown projects has already required it to adjust its future capacity planning with the result that it has much less planning flexibility to address Mon Valley's delays. WP S-9 at 6. West Penn's ability to serve its customers is affected more severely by Mon Valley's requested indeterminate schedule delays than by the delays sought by the Milesburg and Burgettstown Projects.

3. Armco/Allegheny. (RB at 2-4)

For the Commission to grant the modification requests, Mon Valley must prove that the original contract is contrary to the FERC PURPA regulations and that the new contract, as modified, would comply with those regulations. The new contract would not comply with the regulations because it would include a capacity rate calculated before the developers incurred a legally enforceable obligation to deliver power to West Penn. Also, the changes sought here are more than the milestone changes presented in *Milsburg II* and *Burgettstown*. Mon Valley seeks changes in the type of power plan to be constructed, the length of project financing, the power plant ownership, as well as the milestone dates.

Unlike in *Milesburg II* and *Burgettstown*, the proposed changes relate to a contract already approved by the Commission. Also, here the changes are not made only because of contract approval delays, but instead to take advantage of beneficial changes in the marketplace occurring since the contract signing date. Tr. 85. Finally, West Penn does

not need the proposed Shannopin base-load coal-fired generating facility because the next avoidable unit on its system is a combustion turbine peaking unit (MN Ex. 39 at 2; Tr. 410-411); West Penn's current avoided costs are zero (WP S-6 at 30); and construction of the Project at the original contract capacity rate (without an increase owing to a later in-service date) would result in payments in excess of avoided cost by West Penn's ratepayers of over $500,000,000 (WP S-6 at 26-27).

4. Recommendation.

*Milesburg II* and *Burgettstown* do not mandate approval of Mon Valley's requested modifications. The decisions approve of Commission modifications to an EEPA where necessary to save a project threatened by litigation delays. The modifications approved of in *Milesburg II* and *Burgettstown* were the extension of financial closing dates and related milestone dates. Additional modifications are requested here, however. For that reason, *Milesburg II* and Burgettstown alone do not justify modification of Mon Valley's EEPA.

As noted above, the Commission's power to grant modifications is a federally delegated power. The modifications, therefore, can be granted only if they are just and reasonable and within the FERC PURPA regulations. To be approved, each requested modification must meet this test.

E. *Whether the Project Meets PURPA Policy Objectives.*

1. Mon Valley. (MB at 21-23)

Congress enacted PURPA to alleviate the nation's dependence on imported oil. One of the nation's largest uses of oil has been the generation of electricity and, owing to their reliance on oil and gas, electric utilities are experiencing increased costs and decreasing efficiencies. 1978 U.S. Code & Admin. News 7659. Because coal is the single most abundant domestic fossil fuel resource, Congress

noted further that it was essential to find economically and environmentally desirable ways in which to use the nation's abundant coal supplies. *Id.* at 7677-8.

The Shannopin Project meets the public policy objectives of PURPA. The facility will operate with bituminous coal mined from the Shannopin Mine in Pennsylvania. It will be environmentally sound and efficient because it will produce two types of energy from one source of generation. In contrast, West Penn proposes to reactivate oil-fired power plants, the use of which will further increase our nation's dependence on imported oil.

The facility will require up to 360,000 tons of coal annually over the 30 year term of the contract. MV S-3 at 3. The Mon Valley coal supply contract will help to secure the 250 existing jobs at the mine. In addition, construction of the facility will create approximately 350 to 450 jobs and approximately 35 to 40 permanent jobs will result from the ongoing plan operation. MV S-3 at 4; MV S-2 at 18. Development of the project would improve the economic condition of Greene County, which has suffered double digit unemployment. MV S-1 at 1.

2. West Penn. (WP MB at 6-8)

Mon Valley ignores Congress's repeal of certain portions of the Fuel Use Act of 1974 by finding that certain cost-effective uses of natural gas and oil are appropriate. (15 USCS § 792, see note). The Shannopin Project has never been proposed by Mon Valley, or anyone else, as a means to avoid or delay the Mitchell and Springdale units. The capacity rate in the EEPA was not calculated on the basis of delaying the capital costs of oil-fired peaking units, but rather on delaying the capital costs of a base-load coal plan which was once a part of West Penn's generation plans. With or without the involvement of PURPA, West Penn would welcome discussions with Mon Valley regarding the acquisition of energy and capacity from the Shannopin Project at the costs associated with delaying or

avoiding the reactivation of existing oil-fired units. In essence, Mon Valley is now trying to obtain base-load coal capacity prices by incorrectly claiming that it is lessening dependence on foreign. oil. Under PURPA, Mon Valley cannot lessen dependence on foreign oil unless it avoids oil-fired generation.

The promise of limited local benefits is not sufficient justification for burdening West Penn's customers with unneeded capacity. West Penn believes that the Commission will not follow the local perspective stated by Mon Valley's witness, Mr. Joseph J. Michniak, an employee of Shannopin Mining Company and Financial Secretary of United Mine Workers Local 6159, who testified candidly on cross examination:

> Q. [BY ATTORNEY BOEHM] Let me ask you something, Mr. Michniak. As a responsible citizen, you would never want to see a coal-fired plant constructed that wasn't needed by anybody just so it could use union coal, would you?
>
> A. [BY MR. MICHNIAK] If it's going to use union coal, I don't care if anybody needs to buy it.

MV S-5 at 1; Tr. 106.

The real issue here is not whether local interests are served, but whether or not a particular PURPA project is just and reasonable to West Penn's customers and in the public interest. The public policy objective of PURPA is not to develop all conceivable generation projects without regard for need or cost.

3. Armco/Allegheny. (RB at 5-6)

West Penn does not need the base load capacity from the Project. Even at the existing contract capacity rate, the Project will result in overpayments by West Penn's ratepayers in excess of $500,000,000. The proposed capacity rate, therefore, is not in the public interest, espe-

cially since the Project only furthers the narrow financial interests of those who would construct and own the power plant.

The Springdale and Mitchell units are peaking units which have low capacity factors and would use very small amounts of oil. It is not consistent with the objectives of PURPA for large out-of-state and foreign corporate interests to build the facility in the hopes of lucrative profits, thereby requiring West Penn's ratepayers to pay for unneeded, overpriced capacity.

4. Recommendation.

When conceived, negotiated for and accepted by West Penn, the Project met PURPA policy objectives. But for litigation delays, the project would be well into the original milestone dates by now. West Penn originally petitioned the Commission for approval of the EEPA, but then engaged in, and is still engaged in, litigation opposing it. West Penn now argues that it no longer needs the Project's capacity because conditions have changed during the delay created by the litigation for which it is responsible. For this reason, the current need for the capacity of the Project is not a factor here. As the Commonwealth Court stated in *Milesburg II*: ". . . The PUC has full discretion in the exercise of its powers under PURPA and the FERC regulations to encourage the development of cogeneration and small power production *to ensure that litigation delays do not become the factor that determines whether a project proceeds or fails.*" *Milesburg II* at 1349-50. (emphasis added)

The Project's affect on job security, the creation of jobs and the economy of Greene County is laudable, but not essential for PURPA policy objectives to be met. Also, the geographic location of the Project's investors, with which Armco/Allegheny is concerned, has no effect on whether the Project meets PURPA policy objectives.

Despite the litigation delays, the Shannopin Project still will operate with bituminous coal and produce two types of energy from one source of generation. The Project meets PURPA policy objectives.

F. *Whether Mon Valley is Entitled to Modification of the EEPA Because it has Continued Development Activities Despite the Litigation Delays*

Mon Valley argues that it has expended substantial time, effort and money developing the project before and after the EEPA was submitted to the Commission for approval. MV MB at 25-27. As West Penn (WP RB at 9-11) and Armco/Allegheny (A/A RB at 7-9) indicate, Mon Valley's continuing development activities are irrelevant to whether to grant the requested modifications.

The developer of a QF project always has to invest time, effort and money before approval of the project. While the delays in the Shannopin Project were not brought about by the developer, the loss associated with those activities must be borne by the developer if the project is not approved. The Commission does not have the jurisdiction to make the developer whole in such a circumstance. To be approved, the requested modifications must be just, reasonable and within the FERC PURPA regulations regardless of Mon Valley's continued development activities.

G. *Whether the Requested Modifications are Consistent with PURPA.*

1. The Milestone Extensions.

a. Mon Valley. (MV MB at 29-31)

The EEPA milestone dates indicate when the different stages of project development must be completed. The milestone dates include the financing closing date, the interconnection date, the commencement date, and good

faith deposit dates. These dates are intended to assure West Penn that the project is proceeding towards completion. The EEPA provides that it will terminate if the requirements of one of these dates are not met.

The Commonwealth Court recognized in *Milesburg II* and *Burgettstown*, that it would be meaningless to approve an EEPA and then allow the contract to expire because a milestone date, such as the financing closing date, could not be met. —— Pa. Commw. ——, 579 A.2d at ——. (sic) [Mon Valley's reliance on this language is ignored because it does not appear in *Milesburg II*]

The litigation delays have prevented Mon Valley from obtaining financing before the financing closing date specified in the EEPA. West Penn witness Binder admitted that it would be virtually impossible to obtain financing for this type of project while litigation continues. Tr. 340.

Mon Valley will require six months following a non-appealable order to obtain financing. Tr. 49, 159. The schedule of modifications it has proposed for the other milestone dates mirrors the schedule for these dates in the EEPA. Tr. 160-161. Because the schedule is based on a financing closing date six months following a non-appealable order, the extensions are not "open-ended" as West Penn's witness, Albert F. Kave, implied. As the court noted in *Milesburg II*:

> By requiring a financing closing date six months after the issuance of a final non-appealable order, with similar extensions to related milestones, the PUC has retained the sensible protections afforded to the utility by use of the milestone dates, but it has eliminated the effect of regulatory litigation delays.

*Milesburg II* at 1349. The requested extensions would ensure that litigation delays do not become the factor which determines whether an otherwise acceptable and

desirable project proceeds or fails. *Id.* See also *Burgettstown* at 17.

West Penn contends that extension of the milestone dates would disrupt its planning for capacity alternatives. WP S-8 at 2. This contention is without merit. West Penn's April, 1990, Integrated Resource Plan reveals that West Penn has planned for the Shannopin Project to be in-service as late as September, 1994. MV Ex. 39. In addition, the avoided capacity described by West Penn in the calculation of the capacity cost rate contained in the EEPA is based on a 900 MW coal-fired plant consisting of three units to go on line in 1995.75, 1997.75, and 1998.75. Tr. 308; MV S-6 at 20. Thus, the capacity needs which West Penn sought to replace with PURPA projects actually exist until as late as October 1998. Although West Penn's planning interests must be considered by the Commission, West Penn failed to show how the extension of milestone dates in the Mon Valley EEPA disrupts its capacity plans.

The Commonwealth Court found, in *Milesburg II* and *Burgettstown*, that extensions of milestone dates may disrupt West Penn's planning to a certain degree, but held that the Commission had the power to weigh West Penn's planning interest against the PURPA interest and to find that modifications were essential. Comparable extensions are essential to the Shannopin Project.

b. West Penn. (WP RB at 11-13)

Mon Valley is seeking to change avoided costs, which is supposed to be outside the scope of this proceeding.

If Mon Valley's analysis were true, the calculation of avoided costs would have to reflect the later identified utility need. This would result in less of an overlap with West Penn's need thereby reducing the avoided costs. Also, the common facilities (those shared by all three generating units) of the avoided coal plant would have been built with the first unit. Consequently, the avoided

costs embodied in the EEPA would need to be further reduced because the common facilities could not be avoided.

Under the EEPA, the Shannopin Project could go in-service as late as March 1, 1995, without Mon Valley being in default. MV Ex. 1 at 50. Mon Valley fails to justify its request that the Latest Commencement Date under the EEPA be extended to March 1, 1996 or 45 months after the attainment of a non-appealable order, whichever is later. This is beyond the date upon which the avoided costs were based, and amounts to a request to at least change the avoided costs or, quite possibly, to violate the avoided cost standard of PURPA. Section 210 of PURPA restricts the rate which may be established to an amount which cannot exceed "the incremental cost to the electric utility of alternative electric energy," commonly known as avoided costs. Therefore, Mon Valley is asking the Commission to enter an order allowing a violation of the fundamental premise of PURPA.

c. Armco/Allegheny. (A/A MB at 28-31)

The requested milestone date changes are extensive and if granted will constitute a new contract for a new project. WP S-6 at 10. If the Commission grants the contract changes sought by Mon Valley, the legally enforceable obligation of Mon Valley to deliver power to West Penn under the original contract would no longer exist. If the changes are granted, a new calculation of avoided costs as of the date of the new legally enforceable obligation is required under the FERC PURPA regulations.

d. Recommendation.

In *Milesburg II* and *Burgettstown*, the Commonwealth Court recognized that the milestone dates will be fixed because the extensions granted were based on a financing closing date six months after the issuance of a final, non-

appealable order. *Milesburg* at 1349; *Burgettstown* at 17. The court also recognized that the Commission retained the protections afforded to the utility by use of extended milestone dates but eliminated the effect on the QFs of regulatory litigation delays. *Id.*

Mon Valley has experienced the same regulatory litigation delays recognized by the Commission and by the Commonwealth Court in *Milesburg II* and *Burgettstown*. It is, therefore, entitled to milestone date extensions based on a final nonappealable order. West Penn and Armco/Allegheny have petitioned for allowance of appeal of the Commission's Phase I Order to the Pennsylvania Supreme Court. As the Commonwealth Court stated in *Milesburg II* and as noted before in this decision,: ". . . the PUC has full discretion in the exercise of its powers under PURPA and the FERC regulations to encourage the development of cogeneration and small power production *to ensure that litigation delays do not become the factor that determines whether a project proceeds or fails.*" *Milesburg II* at 1349-50. (emphasis added)

Granting the requested milestone extensions will give the Project a chance to be completed, whereas requiring definite milestone dates would provide an incentive to further delay the Project. It is recommended that the milestone extensions be granted.

2. Extension of the In-service Date and Recalculation of the Rate.

a. Mon Valley. (MV MB at 31-33)

The earliest in-service milestone date is significant because it reflects the rate used by West Penn in calculating the capacity rate contained in the Mon Valley EEPA. As part of the milestone date extensions, Mon Valley requested that the earliest in-service date for the project be extended from September 1, 1992 to September 1, 1994. Like the extension of the other milestone dates,

extension of the earliest in-service dates is appropriate given the delays to the project.

In Phase I, the Commission accepted and the Commonwealth Court approved of the use of West Penn's method for calculating the capacity cost rate. The calculation is based on the need for a new 900 MW coal fired power plant with three 300 MW units to come on line in 1995, 1997, and 1998. The costs of the three units determine the cost of the total facility in October 1995, the time West Penn needs the first unit of the plant on line. To calculate the capacity rate for the QFs that are to come on line before October 1995, West Penn discounts the value of the total avoided costs for the facility by an annual percentage to the earliest in-service date for the project. MV S-6 at 21. This means that the rate for a project with an earlier in-service date is reduced by a greater amount.

When it granted similar relief in *Milesburg II*, the Commonwealth Court found no inconsistency when it allowed the Milesburg capacity rate to be recalculated on the basis of the later in-service date. The court stated that West Penn's avoided costs do not change with a project's in-service date:

> The in-service date is not a component of West Penn's avoided costs, or the cost of the 300 MW coal unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's *costs* do not change with changes in a Project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

*Milesburg II* at 1350.

The court further held that allowing the rate to be calculated as of a later in-service date is one aspect of how the Commission must alter a contract so that a QF does not suffer from the delays resulting from litigation.

West Penn's avoided costs are not at issue in this proceeding. As the court noted in *Milesburg II*, however, it is both consistent and equitable to adjust Mon Valley's capacity rate to reflect the later in-service date. Had Mon Valley originally anticipated an in-service date as late as the one that will now occur, its rate would have reflected its proximity to the actual need of West Penn. Allowing a rate based on a later in-service date would reflect the increased costs of construction and inflation during the time of delay. A recalculated rate would reflect a less severe discount from West Penn's constant avoided costs and, therefore, is both reasonable and equitable. As PURPA regulations require, the rate will remain below West Penn's avoided costs.

b. West Penn. (WP MB at 20-21; RB at 13)

Mon Valley's witness, Mr. Buras, presents the recalculation as a simple matter of doing a present value discount of an avoided cost. MV S-6.

Under the terms of the EEPA, a fixed capacity cost rate of 4 cents/kwh was to be paid to Mon Valley by West Penn's customers for capacity from the Shannopin Project starting no earlier than September 1, 1992, but no later than March 1, 1995. MV S-1 at 29, 40, WP Ex. 6 at 4. However, on cross examination, Mr. Buras admitted that the request to recalculate the capacity cost rate amounted to a formula rate. Tr. 193.

Moreover, West Penn's Mr. Binder explained in his cross examination that changing the in-service date of the Shannopin Project and changing the projected in-service date of the avoidable utility plant actually changes the avoided capacity cost. It is not simply a matter of discounting, but it is the impact of delaying utility capacity that determines the avoided cost under West Penn's method. Tr. 303-310. The value of avoided capacity is based on the deferral of capacity. It can be changed

by a change in what is deferred or by the length of the deferral. Mon Valley seeks the latter.

This may seem a bit confusing, but this is because no avoided capacity cost has been established in the proceedings on the Shannopin Project as the result of the appellate court action. As long as the avoided costs remain uncertain for regulatory purposes, the impact of Mon Valley's proposed formula rate shall remain obscured.

Mon Valley wants a higher rate because of the litigation delays even though it had agreed to a constant 4 cent rate in the EEPA for project delays to March 1, 1995.

c. Armco/Allegheny. (A/A MB at 35-39; RB at 10)

West Penn does not need Mon Valley's base load capacity and its current avoided costs are zero. The original Mon Valley contract should be allowed to lapse in light of the current capacity needs of West Penn and its customers. Although this may mean that Mon Valley would be required to take alternative actions with respect to the Shannopin Project (i.e. sell the project electricity to another utility under 18 C.F.R. § 292.303(d) or delay project development), this result is required by PURPA.

The developers took the risk that they might lose money (Tr. 120-121) and they also had the potential to earn a huge return on their investment. Now that the developers see that the deal they are proposing is not economical, they should not be bailed out by the ratepayers. The legislative history of PURPA demonstrates that utility ratepayers are not required to subsidize cogenerators or small power producers. H.R. Conf. Rep. No. 95-1750 at 98 (1978); U.S. Code Cong. and Admin. Nos. 1978 at 7831-7832.

Here, the Commission has the opportunity to prevent the addition of excess capacity before it is built. The

Commission should not approve of the construction of the Shannopin power plant, knowing ahead of time that it will not be needed.

d. Recommendation.

The FERC's rules provide if a rate equals a utility's avoided costs, the rate is just and reasonable and in the public interest. 18 CFR 292.304(b)(2) and 18 CFR 292.304(a)(1). The United States Supreme Court upheld a FERC's decision that rates reflecting avoided costs are *per se* just and reasonable and in the public interest in *American Paper Institute, Inc. v. American Electric Power Service Corp.*, 461 U.S. 402, 418 (1983).

By extending the in-service date and recalculating the capacity rate on that basis, Mon Valley does not seek a rate in excess of West Penn's avoided costs. This rate cannot be calculated until the Commission issues its final determination in Phase I. What Mon Valley seeks here is the adjustment of the in-service date of the facility that will be the basis for the rate calculation, when that calculation is made.

As noted above, West Penn's method, calculates the capacity rate to be paid to a QF by first determining the avoided cost of a 900 MW plant (comprised of three 300 MW units coming on line in 1995, 1997 and 1998) as of 1995. That figure is then discounted to the in-service date of the QF. In *Milesburg II*, the Commonwealth Court directed the Commission determine West Penn's avoided costs in accordance with the Court's findings and West Penn's method. The rate to be received by the QF will be determined by applying the appropriate discount rate to the avoided cost figure as of 1995.75 to the appropriate in-service date.

Mon Valley witness Mr. Buras explained that the curve reflecting the discount value of avoided cost produces different present value numbers depending on when the

plant goes on line. This means that a later in-service date will not change the avoided cost, as long as the rate is derived from the same curve. MV S-6 at 23-4.

West Penn witness Mr. Binder acknowledged that the discount ensures that the rate remains below full avoided costs even though the rate increases for later in-service dates. Tr. 308-310. It seems that, at least until 1995.75, tying the capacity rate to the modified in-service date is consistent with keeping the rate at or below avoided costs. Tr. 355.

In *Milesburg II*, the Commonwealth Court addressed this issue directly. It held that although the change in the project's in-service date changes the rate to be received by the project, West Penn's avoided costs remain constant. The Court also stated:

> [h]ad the parties originally anticipated an in-service date as late as the one that will now occur, the capacity credit would have been higher to reflect the closer match to the actual capacity needs of the utility. The PUC's accounting for that fact is simply one aspect of its efforts to approve a contract that has not been altered to the detriment of the QF by the delays resulting from this litigation.

*Milesburg II* at 1350.

Likewise, in this proceeding, the change in the in-service date of a facility does not result in a rate that exceeds West Penn's avoided costs. Instead, it remedies the effects of litigation delays on the Shannopin Project.

In asserting that the recalculated rate changes its rate from a fixed rate to a formula rate, West Penn argues against the way its method computes avoided capacity costs. It is able to do so, however, only because the delays, in which it played a part, gave rise to the instant petition for modification of the EEPA. The West Penn formula has not changed. What has changed are the

results of the formula as applied to modifications requested because of the delay in litigating the merits of the EEPA. As noted above, when the Commission determines the capacity cost in Phase I, it will fall below West Penn's avoided costs. West Penn's concern with the impact of the rate being obscured, therefore, is inconsequential.

3. Change in Boiler.

a. Mon Valley. (MV MB at 34-37)

Mon Valley requested that the EEPA be modified so that it can use a pulverized coal (PC) boiler with a scrubber in its cogeneration plant instead of the circulating fluidized bed (CFB) boiler discussed with West Penn and listed in the recitals of the EEPA. A PC boiler can be constructed in less time than a CFB boiler. The requested modification, therefore, would allow the Project to regain to be put into operation more quickly. Tr. 57, 251-252.

PC boilers are the standard of the utility industry. In fact, all of West Penn's generation facilities use PC boilers. Tr. 322. West Penn is not opposed to the use of a PC boiler in the Shannopin facility. WP S-6 at 33; Tr. 275-276. It had never expressed a preference for the type of boiler to be used. Tr. 249-250.

b. West Penn. (WP MB at 24)

West Penn does not oppose Mon Valley's request to change the technology of the Shannopin Project from a CFB boiler to a PC boiler with a dry scrubber. West Penn, however, has not received sufficient documentation to form an opinion on the reliability and operational effectiveness of the specific pulverized coal boiler and dry scrubber that Mon Valley intends to use. Tr. 277. Consequently, West Penn recommends that the Commission grant this modification on the following conditions: (1)

that the specific pulverized coal boiler and scrubber designs that Mon Valley intends to use are reviewed by West Penn in accordance with Article II of the EEPA and (2) that West Penn and Mon Valley reach agreement on appropriate other changes in the EEPA, including rate of response, minimum load and reagent stockpiles, to address this change in technology.

c. Recommendation.

Mon Valley's Reply Brief does not respond to West Penn's conditions. It is assumed, therefore, that Mon Valley does not differ with the conditions associated with changing the CFB boiler with a dry scrubber. Accordingly, this modification will be granted subject to the conditions enunciated by West Penn.

4. The Extended Financing Term.

a. Mon Valley. (MV MB at 37-38)

Mon Valley requests an EEPA modification so that it can seek a financing term not exceeding 25 years instead of the 15 years stipulated in the current EEPA. This modification should improve Mon Valley's ability to obtain financing for the project and reach financing closing more quickly.

Increasing the financing term reduces the amount of principal and interest payments the project must make initially. Tr. 144. Because the Project will pay less debt service initially, the risk to the ratepayers that the project will fail is decreased. This reduced risk also makes the Project more attractive to potential financiers and will enable the project to obtain financing more readily. Tr. 52, 144.

West Penn contends that an extended financing term substantially increases risk to its ratepayers by extending the amount of time that West Penn's interest in the proj-

ect is subordinated to the interest of the senior construction lender. WP S-6 at 31-33. This argument is without merit. Under the terms of the EEPA, West Penn retains the position of a subordinated lender to the project, even though it has not provided any equity to the project. Tr. 326. If the Project were to default, West Penn would be in a position to take it over. Mr. DePre indicated that a subordinated lien increases the ability of a utility to take over a project. Tr. 147.

Mon Valley has not questioned West Penn's subordinate lien. Regardless of the length of the financing term, West Penn would retain this protection for the ratepayers. Allowing an extended financing term, however, would decrease the possibility of default by reducing the project's initial debt repayment obligations. The fact that an extension of the financing term will not adversely affect West Penn is reflected in Mr. Binder's acknowledgement that West Penn could accept an 18 year term. Tr. 274. This clear benefit to the project's long-term viability outweighs any potential risk to the ratepayers and justifies the requested relief.

b. West Penn. (WP MB at 21-23)

In attempting to increase the financing term of the Shannopin Project from 15 years up to 25 years, Mon Valley erroneously represents that increasing the financing term does not affect West Penn because it "has second liens and mortgages in the [project] assets behind the senior lender." MV S-6 at 18. The second mortgage contemplated in the EEPA can be an effective, low cost mechanism providing West Penn's customers with reasonable assurance that their primary interest, kilowatt-hours, will be available over the term of the contract. The right to obtain kilowatt-hours can be much more important to a utility and its ratepayers than the right to access project assets and cash. The second mortgage in the EEPA provides a security interest somewhat different

than the traditional notion of secured financing to provide assets as security for repayment of a loan.

Mon Valley's request is overly broad. Increasing the financing term increases developer profits and improves debt coverage ratios on one hand, but, on the other hand, it decreases the value and, hence, the effectiveness of the second mortgage.

The inverse relationship between the length of financing and the level of security provided by the second mortgage in a PURPA transaction is explained in West Penn Statement 6 at 30-34. Also, the article entitled "Controlling Risk," published by West Penn witness Albert F. Kave, Jr. in the April 1990 issue of *Cogeneration & Resource Recovery*, comprehensively discusses the value and importance of a utility second mortgage in a PURPA contract and how its value to ratepayers can be defeated if care is not exercised in controlling the financing term. WP Ex. 46.

In view of the foregoing and the failure of Mon Valley to determine the equity that will be contributed to the project, Mon Valley's modification request to be granted flexibility to extend the financing term should be denied at this time.

c. Armco/Allegheny. (A/A MB at 26-27)

Armco/Allegheny relies on West Penn's argument, summarized above.

d. Recommendation.

Increasing the financing term benefits Mon Valley for the reasons summarized above, but it also diminishes the value of West Penn's second mortgage. In benefiting Mon Valley, an extended financing term also benefits West Penn because it decreases the possibility of default by reducing the project's initial debt repayment obligations. Also, there is no guaranty that Mon Valley will

be able to receive a twenty-five year term of financing if this EEPA modification is granted. Nevertheless, a twenty-five year term appears to be too long. West Penn agreed to eighteen years, but Mon Valley should have more flexibility. Based on this record, Mon Valley should be given the flexibility to try to obtain financing with a twenty year term.

5. The Assignment of Mon Valley's Interest in the EEPA to Mon Valley Energy Limited Partnership, Which Would Have as its General Partners Mon Valley Energy Corporation and CMS Generation Mon Valley Company, a Wholly Owned Subsidiary of CMS Generation.

a. Mon Valley. (MV MB at 39-41)

In its Petition and in its Supplement to the Petition, Mon Valley requested that the Commission grant "any and all other relief that is just and equitable." Throughout the course of this litigation, West Penn has not been willing to discuss reasonably with Mon Valley matters related to the Project, even where such matters will have no adverse effect on West Penn and would enhance the Project's development. One such issue is Mon Valley's request that it be permitted to assign its interests in the EEPA to Mon Valley Energy Limited Partnership, which would have as its general partners Mon Valley Energy Corporation and CMS Generation Mon Valley Company, a wholly owned subsidiary of CMS Generation. Because this is an unresolved issue which West Penn has never opposed on its merits, Mon Valley respectfully asks that this matter be resolved in this proceeding to avoid further unnecessary litigation delays.

Mon Valley previously advised West Penn, in its letter dated August 9, 1990, of its request that West Penn agree to consent to assignment of the EEPA to a limited partnership. MV Ex. 29). As West Penn knew, CMS

Generation had become involved with the project and had provided considerable development support. West Penn refused to contemplate any of Mon Valley's proposals. MV Ex. 30.

In the interest of proceeding with the Project and in view of West Penn's unwillingness to discuss even the most perfunctory matters related to the EEPA, Mon Valley filed its notice of Self-Certification with FERC identifying the anticipated owner of the Project as Mon Valley Energy Limited Partnership. MV Ex. 24. The Notice further identified the general partners of that limited partnership as Mon Valley Energy Corporation and CMS Generation Mon Valley Company, a wholly owned subsidiary of CMS Generation.

West Penn has not presented any objection to the involvement of CMS Generation, and, in fact, should welcome the formal involvement of CMS Generation, an affiliate of Consumers Power Company. See MV Ex. 24. Permitting such assignment benefits the Project by formally joining a CMS Generation subsidiary and structuring the ownership in a partnership form. The Commission has the authority to so modify the EEPA because it would benefit the project, cause no detriment to West Penn or its ratepayers, and helps serve the interests of PURPA.

b. West Penn. (WP RB at 5)

West Penn's only reference to the change in ownership of the Project is in a list of reasons why the circumstances and timing of the requested modifications are different from those facing the Commission when it issued its rulings in the Phase II proceedings on the Milesburg and Burgettstown projects. One of the reasons, also quoted above, follows:

> Unlike the other projects, Mon Valley requests a change in the ownership of the Shannopin project. This request of the Commission first surfaced in Mon

Valley's main brief. Before forming an opinion on this request, West Penn would like to exercise its right under the EEPA to review the specific documents to accomplish the ownership change. To date, Mon Valley, despite its obligation under the EEPA, has not furnished West Penn with the documentation. Mon Valley's request is late in the context of the hearing process, but at the same time, is premature in the context of rational contractual administration of PURPA projects.

c. Armco/Allegheny. (A/A MB at 28)

CMS Generation is a nationwide developer of independent power plants and is a subsidiary of CMS Energy. MV S-6 at 2. CMS Energy is the largest electric utility in Michigan. *Id.* at 2-3. The change in power plant ownership is significant in an engineering sense because the owners and operators could affect plant operation and performance. It is significant in a legal sense because the principal parties to the contract would no longer be the same.

d. Recommendation.

Although the change in ownership is advanced for the first time in Mon Valley's Main Brief, West Penn withholds an opinion on the request until it exercises its right under the EEPA to review the specific documents to be used to accomplish the change. Although this is reasonable, it does appear that the assignment of the contract and the formal involvement of CMS will benefit the project by providing the financial and technical support of a utility subsidiary. MV S-6 at 3-4. Armco/Allegheny failed to present any evidence or acceptabe argument indicating that the involvement of CMS Generation will affect the project in any detrimental way, if at all. The requested change in ownership will be granted because the assignment of the contract and the formal involvement of CMS

does not affect the contract itself and should benefit the Project, West Penn, and West Penn's ratepayers.

6. Whether the Commission should Defer its Decision on the Modifications until the Pending Appellate Court Action and the Commission's Determination of the Capacity Rate are Concluded.

a. West Penn. (WP MB at 10-11)

The Commission should not make any decision on the modifications of the EEPA sought by Mon Valley until the capacity rate issue in the proceeding at this docket is resolved by the appellate courts. Before the Supreme Court of Pennsylvania is West Penn's petition for allowance of appeals from the Commonwealth Court decision reversing the Commission decision on the proper time frame to be used to calculate the capacity rate of the Shannopin Project. (Pennsylvania Supreme Court Allocatur Docket No. 545 W.D. 1990). Until a decision is made by the Supreme Court, even if that decision is a refusal to hear the appeals, the costs to be incurred by West Penn's customers for the proposed project's capacity are unknown.

Until the project's capacity rate is known, it is uncertain whether Mon Valley will proceed with the project. Under the Commonwealth Court's decision now pending allowance of appeal in the Pennsylvania Supreme Court, a recalculation of the capacity rate is to be made by the Commission using inputs in existence at the time the EEPA was signed, October 15, 1987, rather than as of the time of serious negotiations between the parties, i.e., September 10, 1986. Also, the Commonwealth Court directed the Commission to offer Mon Valley the opportunity to decline to proceed with the Project should the recalculation prove to be less than that to which West Penn and Mon Valley initially agreed during the time of serious negotiations. (No. 2091 C.D. 1989).

An opportunity for Mon Valley to decline to proceed with the project is possible, regardless of the eventual outcome of the appellate process. Consequently, the Commission should defer its decision on the requested contract modifications until it is determined whether Mon Valley will or will not proceed with the project. If Mon Valley decides not to go ahead, the Commission will not have to decide whether to grant the modifications.

If Mon Valley decides to proceed with the project after the capacity rate issue is resolved, the Commission, if it defers its decision on the modifications, can evaluate the modifications with all relevant and current information. Mon Valley supports its request for contract modifications by a belief that it should be entitled to benefit from all current information available to it. West Penn should likewise be permitted to place its information into evidence for the Commission's consideration in making its decision on the modifications. West Penn believes that it was prevented from submitting relevant evidence on behalf of its customers to show that the modifications are not in the interest of its customers or the public generally. The evidence was excluded because of the ALJ's application of Pennsylvania Rule of Appellate Procedure 1701(a) which is designed to promote orderly court proceedings by avoiding inconsistent rulings by an appellate court and a governmental agency. The rule is not intended to exclude relevant evidence.

If the Commission does not defer its decision on the contract modifications it is likely that there never will be another opportunity to make the decision based on all current and relevant evidence.

b. Mon Valley. (MV RB at 21)

If the Commission defers its decision on the requested modifications the project would be delayed further. When Mon Valley requested that West Penn agree to reasonable extensions that clearly fell within West Penn's planning

guidelines, West Penn rejected Mon Valley's proposal. West Penn's complaint that the uncertainty surrounding the Shannopin Project has disrupted its planning is thus contradicted by its own planning schedule. West Penn would use its own generation sources by reactivating oil-fired plants currently in cold storage. Eliminating the Shannopin Project allows West Penn to pursue its own "planning alternatives" without the possible interference of an independent generation source.

West Penn's implication that Mon Valley has attempted to benefit from the delay by requesting the modifications has no merit. West Penn would have the Commission defer its decision so that any appeals of Phase II would have to be taken after Phase I has been concluded. This would serve only to further delay the approval process. Mon Valley seeks to ensure that all issues are resolved within the same time frame as Phase I so that, upon resolution, it can proceed with the Project as soon as possible.

c. Recommendation.

There is no reason to further delay the project by deferring a decision on the requested modifications. The issues in this proceeding have been litigated fully and the proceeding is ripe for decision regardless of the outcome of West Penn's Petition for Allocatur. Mon Valley should be able to decide whether to proceed with the Project, depending on the capacity rate, after it knows whether its modification requests are granted.

West Penn did not seek Commission review of the ruling of the undersigned to exclude evidence of West Penn's avoided costs, and, therefore, has waived the opportunity to raise this issue again in the briefing stage of this proceeding. Even so, when the Commission determines West Penn's avoided costs pursuant to the Commonwealth Court's mandate, the rate to be received by Mon Valley will be determined. Because it will fall below West Penn's

avoided costs, the rate will be *per se* just and reasonable and in the public interest according to the FERC regulations. West Penn's suggestion that a decision on the modifications be deferred should be ignored.

H. *Whether Granting the Proposed Modifications Would Shift a Substantial Risk to West Penn's Customers and Impose Serious Planning Risks on West Penn.*

1. West. Penn. (WP MB at 12-20)

Mon Valley is attempting to improve its position in the EEPA at the expense of West Penn's customers. A PC boiler is more economical than a CFB boiler, but no savings are proposed to be passed on to West Penn's customers. Cogeneration plants are energy efficient and environmentally sound, but only as long as the plants are needed. The Project is not necessary for the survival of the Shannopin Mine. The owners of the Project can look forward to an after-tax return on equity in the range of 20-25%, twice the return on equity granted to West Penn in its last rate case. The prospect of such a high return shows that the Project's owners, not West Penn's customers, should bear much of the development risks of the Project, including the risk of delays because of litigation. The out-of-state ownership of the Project has not shown any meaningful concern for the concerns of West Penn's customers.

West Penn's customers face a total cost of about $1,250,000,000 under the EEPA without modification. This is excessive because with the passage of time, West Penn's next planned addition of new generating capacity has changed from a base load coal plant to CTs and that base load generation is not needed in this century. WP S-t at 11-12; MV Exs. 38, 39.

The requested modifications are so extensive that they would create a new EEPA between Mon Valley and West Penn with a shift of substantial risk to West Penn's customers. The negotiation of the EEPA is a process of

achieving a balance of risks among the developer, the utility and the ratepayers. In September of 1986 when the agreement in principle on price was reached, the date at which West Penn's ratepayers would need additional generating capacity was projected to be 1995. By making a commitment in 1986 on the capacity price to be paid to the Project, West Penn made it easier for Mon Valley to invest the time and effort necessary to negotiate a purchase agreement. However, such a commitment to price reduced West Penn's generation planning flexibility and the ability to benefit from subsequent technological advancements or changes in circumstances such as slower load growth or different generation costs that could reduce West Penn's future costs. As a result, West Penn and its ratepayers assumed some risk. In return, certain conditions were required to be met in order to keep the price and the EEPA valid. WP S-6.

Included in those conditions were several deadlines and the risk that Mon Valley might not be able to meet them was one that it voluntarily assumed to obtain the price commitment from West Penn. Mon Valley now seeks to maintain the benefit of West Penn's price commitment and thereby require West Penn's ratepayers to pay a higher price for power even though avoidable costs and capacity needs have changed. Mon Valley wants West Penn and its ratepayers to bear both the risks West Penn originally agreed to assume (the pricing commitment) and the risks that Mon Valley originally agreed to assume (the schedule commitment). *Id* at 11-12.

Granting the modifications would impose serious planning risks on West Penn. The Company's ability to serve its customers is dependent upon its ability to have appropriate and flexible plans for meeting future customer load. PURPA project failures and schedule delays destroy this capability and are a major concern for West Penn in view of recent experiences under PURPA. WP S-9 at 4.

The impact of PURPA failures and delays on the generation plans of West Penn and the other Allegheny Power System (APS) companies has been extensive. These planning risks include both the delays of current projects and the impact of previous projects which have been removed from generation plans but which have also delayed construction of APS capacity. The total planning risks which have been caused by PURPA projects amount to over 14,500 megawatt-months of delay (an average delay of about 700 megawatt-months per project as of April, 1990). One way to visualize the potential impact of this risk is to look at the effect on meeting projected customer demand. Assuming an annual peak load growth of 120 MW for APS, this planning risk is theoretically equivalent to *over 10 years* of not meeting new peak load requirements. *Id* at 5.

APS has minimized the detrimental effects of PURPA project failures and delays by the timely removal of PURPA projects from generation plans, the ability to reschedule the reactivation of West Penn capacity in cold reserve, transactions with other utilities, the ability to cancel sales to non-affiliated customers, the high availability of APS generating units, the use of a PURPA contingency in generation plans, and adequate generation reserves. The APS companies have been able to avert serious consequences of PURPA project failures by utilizing flexibility available in the planning and operation of the power system. Having depleted much of that flexibility, West Penn must not be further strained by the uncertainties of Mon Valley's indeterminate schedules.

West Penn has the legal obligation under Section 1301 and 1501 of the Public Utility Code to provide adequate and reliable electric service to its customers at a reasonable cost. The Virginia State Corporation Commission recognized this in a related context in its order in VSCC Case No. PUE860058. The Virginia Commisison stated:

"In deciding this question we have kept in mind one overriding principle: It is Virginia Power which has the legal obligation to provide adequate and reliable sources of electric energy within its service territory, and the Commission must insure that the Company is permitted to carry out that duty in a reasonable, effective and flexible manner based on the best information available to it at the time the necessary decisions must be made. An adequate supply of electricity is essential for continued industrial and commercial growth in the Commonwealth of Virginia, and the ratepayers have as much right to expect this power to be available as they have to expect that it will be furnished at reasonable and just rates. . . . The hope embodied in PURPA and its related regulations is that, by requiring the utility to purchase 'any energy and capacity which is made available from a qualifying facility,' the utility will find it possible and prudent to avoid, under proper circumstances, costly new construction as part of a responsible and flexible planning process. However, it is the duty of the utility, subject to approval and continuing oversight by this Commission under Virginia law, to exercise managerial discretion in determining when circumstances are appropriate in any specific case to forego the construction of additional facilities without endangering the ability to serve the projected needs of the public."

This proceeding reflects an effort by West Penn to exercise managerial discretion, based on the interests of its customers, in administering PURPA transactions so that important flexibility in planning new generating capacity is not destroyed. In this case, the PURPA owner-developer is seeking to avoid the consequences of risks that it assumed in negotiating a power sales contract by asking the Commission for contract modifications which transfer substantial financial and service reliability risk to

West Penn's customers. The Commission should not permit this request.

2. Mon Valley. (MV MB at 41-45; RB at 7, 12-13)

In his direct testimony, Regis Binder asserts that preserving the Shannopin Project will cost West Penn's ratepayers in excess of $500 million. WP S-6 at 26-27. This figure is based upon the assertion that West Penn's "current avoided costs are zero." WP S-6 at 30. These unsubstantiated statements can not support the assertion that the Shannopin Project is not just and reasonable and in the public interest. In his Second Prehearing Order, ALJ Gesoff ruled that the evidence relating to avoided costs was to be stricken because the avoided costs ultimately determined as a result of the Phase I proceeding would determine the rates to be received by Mon Valley. Because Phase I is the subject of appeals to the Pennsylvania Supreme Court, the Commission does not have jurisdiction over Phase I matters like avoided costs. (Second Prehearing Order at p. 3).

The planning concerns that West Penn raises could have been resolved by agreeing to a reasonable extension of the financing closing date as requested by Mon Valley. As the Commonwealth Court noted in *Burgettstown*, the Commission has the power to weigh the planning interest of West Penn to the interest of preserving PURPA projects and to decide to extend the financing closing date to a time six months after the entry of a non-applicable order and to adjust related milestone dates accordingly. *Burgettstown* at 17. None of the modifications requested by Mon Valley have a negative impact on West Penn, and, therefore, should be granted by the Commission.

West Penn's April 1990 Integrated Resource Plan anticipates the Shannopin Project coming on-line at the same time requested by Mon Valley. MV Exhibit 39. In its first settlement proposal and its Petition for Modifica-

tion, Mon Valley stated that the earliest in-service date be extended by only one year to September 1, 1993. West Penn would not agree to this extension even though its current generation plan anticipated the Shannopin Project coming on-line a full year later. Tr. 397.

In its second settlement proposal and Supplement to the Petition for Modification, Mon Valley requested a two year extension of the earliest in-service date to September 1, 1994, the in-service date for the Shannopin Project contained in West Penn's April 1990 Integrated Resource Plan. West Penn again refused to agree to the extension even though its plan anticipated the date proposed. When presented with the opportunity to extend the in-service date in conformity with its own plan, West Penn failed to remedy its planning concerns by agreeing to the extensions.

In Phase I of these proceedings, the Commission found that West Penn's stated goal for a 25% reserve margin was reasonable. 106 PUR 4th at 469. The April 1990 Integrated Resource Plan, however, reveals that West Penn would sacrifice its reserve margin in the interest of removing PURPA projects from its generation plans. Without the addition of 80 MW of generation from the Shannopin Project in 1994, West Penn's reserve margin would remain well below the 25% goal. MV Ex. 39; Tr. 385.

West Penn contends that the planning uncertainty caused by the PURPA projects has inhibited its generation planning. It maintains that extensions harm its ratepayers because they prevent West Penn from pursuing planning alternatives. When asked at his deposition why West Penn refused to allow milestone extensions that exceeded six months, Regis F. Binder stated:

> The sooner that West Penn is free to take whatever other actions it can to obtain the [alternate] generation sources, the less uncertainty there is in the plan.

> By keeping the milestone dates as they are, we hope to be able to take whatever action we need to sooner.

Tr. 337. Mr. Binder maintained that refusing to agree to longer extensions was not an attempt to kill the project so that West Penn could pursue its own planning alternatives. Tr. 336-8. Yet, he acknowledged that it would be virtually impossible to obtain financing within the time frame West Penn proposed. Tr. 340. Instead of agreeing to longer extensions for the project in an attempt to lend certainty to its generation plan, West Penn preferred to offer unrealistic, limited extensions so that it could pursue its own alternatives.

In pursuing its planning alternatives, West Penn intends to reactivate its Mitchell 1 and 2 and Springdale 7 and 8 oil-fired units. These four units were first placed in service in 1945, 1948, 1949 and 1954. Tr. 389. The units have been in cold-storage since 1985, 1982, 1982 and 1984. Tr. 389. Despite the statement of Congress that PURPA is intended to decrease reliance on foreign oil, West Penn intends to incur the expense of reactivating these oil-fired units. Although he stated that actual oil prices have been below the projected prices, Mr. Kave's testimony emphasized the utility's continued reliance on foreign oil as opposed to alternative sources. West Penn's April 1990 Integrated Resource Plan contemplates only 82 MW of new PURPA power in the next 10 years. MV Ex. 39. Of that, 80 MW involves the Shannopin Project, which West Penn apparently hopes to eliminate.

West Penn's stated concern that its planning may be disrupted by modifications of QF projects masks the fact that West Penn seeks to minimize or eliminate PURPA projects and own all sources of generation in its territory. West Penn's planning activities indicate only minimal attempts to include PURPA for planning. In its most recent plan, it removed all but two PURPA facilities. West Penn prefers to rely on alternatives that directly contradict the purposes of PURPA.

It is this planning interest that the Commission should balance with the interest in promoting the independent power projects in Pennsylvania. In this case, West Penn's planning will not be disrupted by the requested modifications, which correlate to West Penn's own planning projections. In addition, the Commission has the power to decide the continued survival of PURPA projects in Pennsylvania further supports the modifications. (See *Burgettstown* at 17).

3. Recommendation.

Mon Valley's argument is persuasive, although its reference to Mr. Kave's testimony will be ignored because that testimony was not admitted into the record. It is the Commission's function to consider both the effect of the Project on West Penn's capacity planning and the interest of promoting cogeneration projects in Pennsylvania. The delays in the Project have allowed West Penn to argue that its avoided costs have changed and that now its capacity planning based on different assumptions. But this argument would not exist without the delay which West Penn, itself, has played a prominent part in creating. As the Commonwealth Court stated in *Milesburg II*:

> By requiring a financing closing date six months after the issuance of a final non-appealable order, with similar extensions to related milestones, the PUC has retained the sensible protections afforded to the utility by use of the milestone dates, but it has eliminated the effect of regulatory litigation delays.

*Milesburg II* at 1349. Whatever planning difficulties West Penn now faces are, in part, its own creation and do not outweigh the interest of promoting cogeneration projects in Pennsylvania.

I. *Whether the Requested Extension of the EEPA Milestone Dates Might Violate PURPA.*

1. West Penn. (WP MB at 24-26)

The foundation of PURPA is the avoided cost standard under which payments to an owner for power from a QF can not exceed the costs the utility would otherwise incur by producing the power itself. 16 USCS § 824a-3. Obviously, a utility cannot avoid the construction of capacity which has already been constructed. Correspondingly, if a scheduled in-service date of a PURPA project is after the scheduled in-service date of the utility plant to be avoided, then the utility plant cannot be avoided by the PURPA project.

The capacity rate in the EEPA for the Shannopin Project is based on a 1995 in-service date of avoided capacity. Tr. 355. The indeterminate schedule requested by Mon Valley creates a substantial possibility that the in-service date of the Shannopin Project could be after the in-service date of the West Penn "avoided plant" that is eventually used for the calculation of an avoided capacity rate for Mon Valley. This is impermissible under PURPA.

Also, West Penn's methodology for calculating avoided costs which was used for the Shannopin Project, and is still being used by West Penn, is based on the theory that a generating source can only avoid utility capacity if the source is available no later than the planned in-service date of the utility's capacity. The formulas in that method are not applicable if the nonutility source is expected to come in-service after the in-service date of the avoided capacity. (West Penn Statement 7, pp. 6-7).

To assure that PURPA is not violated and to allow for the future application of West Penn's method for calculating avoided costs, the schedule dates should not be later than the scheduled in-service date of West Penn's capacity considered to be avoided by the Shannopin Project.

2. Recommendation.

The switch to a PC boiler will hasten the in-service date of the Project. Also, if there are no further litigation delays, the in-service date of the Project should occur before the planned in-service date of West Penn's avoided capacity. Finally, West Penn treats the planned in-service date of its avoided capacity as a precise date rather than a projection, which is its true nature. The possibility raised by West Penn is remote and should not result in the denial of the requested modifications. West Penn's reference to Mr. Kave's testimony is ignored because his testimony was not admitted into the record.

J. *Whether the Shannopin Facility is a QF.*

1. Armco/Allegheny. (A/A MB at 32-35)

There is no provision in PURPA or the FERC PURPA regulations regarding utility transactions with potential QFs or facilities which may be certified as QFs at a later date. Also, 18 C.F.R. § 292.304(d) requires avoided costs to be calculated at the time a *QF* incurs a "legally enforceable obligation" to deliver power. Until a non-utility generator is certified as a QF by the FERC, a utility cannot be required to purchase the non-utility generators electricity and no other PURPA benefits are applicable. Because the Project could not be deemed to be a QF before its Notice of QF Self-Certification with respect to a PC boiler on November 16, 1990 (MV Ex. 24), the avoided cost based capacity rate in this proceeding cannot be calculated before that date.

2. Mon Valley. (MV RB at 16-19)

The Shannopin Project meets all of the criteria for a QF enumerated in the FERC regulations. The Project will provide useful thermal energy in the form of low pressure steam to an independent business. At least 5% of the total energy output of the facility will be sold to that independent business. The project's ownership structure

does not contemplate that an electric utility, affiliate of an electric utility, or combination of utilities or utility affiliates will own more than 50% of the equity of the project. MV Ex. 24; MV S-2 at 2-4; 18 CFR §§ 292.205 (a) and 206. The project has not altered from these criteria since its inception. Although Armco/Allegheny argue that the project is not a QF, they present no evidence to the contrary.

Armco/Allegheny cite no case law in support of their position that the project must be certified by FERC as a QF before it is entitled to relief. They simply cite 18 CFR § 292.207 which delineates two certification procedures. Section 292.207(a)(1) clearly states, however, that "[a] small power production facility or cogeneration facility which meets the criteria for qualification set forth in § 292.203 is a qualifying facility." Mon Valley has shown that it qualifies as a QF because it meets the specified criteria.

The Preamble to the FERC regulations discusses the general requirements for qualification and concludes that a facility qualifies when it meets the specified criteria. Certification merely signals previous qualification. 45 Fed. Reg. 17,962 (March 20, 1980). In *Empire Lumber v. Washington Water Power*, 114 Idaho 191, 755 P.2d 1229 (1987), the Idaho Supreme Court noted that:

> Pursuant to Section 201 of the Act, co-generators or small power producers must meet three criteria to become Qualified Facilities (QF). Those criteria encompass size, fuel, and ownership. Upon satisfaction of these criteria, the owner or operator is required to furnish notice to the Federal Energy Regulatory Commission (FERC).

114 Idaho at ——, 755 P.2d at 1230.

The court further noted that the Public Utilities Commission is the

> appropriate forum to resolve whether a co-generator or small power producer has satisfied the criteria for

'qualified facility' status and to determine whether a regulated utility has an obligation under PURPA to purchase power from an applicant.

*Id.*

The Commonwealth Court implicitly recognized that the Shannopin project is a QF when it held in Phase I that the Mon Valley EEPA presented to the Commission for approval is the equivalent of an involuntary petition under the PURPA regulations and that Mon Valley is entitled to a rate based on West Penn's avoided costs at the time the EEPA was signed. At no time did any party question the fact that the project is a QF. In granting the modifications in *Milesburg II* and *Burgettstown*, the court did not require a showing that the projects had received certification before they were entitled to relief. Armco/Allegheny's argument is thus without merit.

3. Recommendation.

Although mentioned tangentially during the hearings in this proceeding, the issue of whether or not the Project is a QF was not litigated by the parties and should not be considered now. Even so, for the reasons enunciated by Mon Valley, the Project is a QF.

K. *Whether the April 27, 1990 Emergency Order was Invalid.*

1. Armco/Allegheny. (A/A MB at 51)

On May 7, 1990, Armco/Allegheny filed a Motion to Rescind the Emergency Order issued by the Commission on April 27, 1990. The Emergency Order granted Mon Valley a stay of the good faith deposit due May 1, 1990. At page 51 of its Main Brief, Armco/Allegheny again challenges the validity of the Emergency Order and incorporates the arguments contained in its motion to rescind by reference.

2. Recommendation.

In its Order On Motion Of Mon Valley Energy Corporation For Stay Of Good Faith Deposit Requirement and Petition For Modification Of Electric Energy Purchase Agreement, entered May 10, 1990, the Commission ruled that Armco/Allegheny had no standing to protest the grant of a stay to Mon Valley and it did not consider its Motion to Rescind. Order at 5-7, 9. The reasoning of the Commission in the May 10, 1990 Order ruling that Armco/Allegheny had no standing to protest the grant of the stay is incorporated herein by reference. For the same reasons, Armco/Allegheny does not have standing to challenge the April 27, 1990 Emergency Order here.

L. *Legal Consideration in Exchange for the Requested Modifications.*

1. OCA. (OCA MB at 13-16)

Mon Valley agreed to the EEPA capacity rates after *negotiating* the terms and conditions of the contract. Here, however, Mon Valley seeks to unilaterally modify certain terms of the EEPA after failing to reach agreement with West Penn on a contract modification. Mon Valley did not offer any concessions in return for the requested modifications. MV Exs. 28, 29. West Penn did agreed to modify the Monongahela Lock & Dam No. 8 EEPA, and the Commission approved of an extension of certain milestone dates. The developer, however, offered concessions, an agreement not to seek or be entitled to an increase in the capacity rate, as an inducement for West Penn to grant the extensions. Tr. 314-316, MV Ex. 33. *Petition of West Penn Re: Monongahela Lock and Dam No. 8*, Docket No. P-880283 (October 30, 1990). In other proceedings, developers offered concessions to the utility in return for EEPA modifications: *Petition of Pennsylvania Electric Company Re: Third Supplemental Agreement with Scrubgrass Power Corporation*, Docket Nos. P-900469 and P-900470 (November 21, 1990)

(Milestone extended and other terms renegotiated in return for a *reduction* in rates); *Petition of Metropolitan Edison Re: Second Amendatory Agreement between Metropolitan Edison Company and Panther Creek Partners*, Docket No. P-890359 (November 21, 1990) (Extensiton of milestone dates in return for a *reduction* in the escalation rate during the last five years of the contract).

Mon Valley's request is for a unilateral change in terms that had previously negotiated by the parties to the EEPA. Mon Valley seeks to modify several material terms of the contract. The Commission must look to the PURPA regulations, but also must be guided by what is fair, equitable and in the public interest. Mon Valley has failed to show that allowing a change in the capacity rate now is just, reasonable and equitable in light of the other material changes to the contract it has requested.

2. Mon Valley. (MV RB at 10-11)

The common law principle of consideration does not apply here. In *Milesburg II*, West Penn argued that common law contract principles must apply to the consent agreement entered between the parties in that case. The Court held, however, that common law contract principles do not apply when a contract has been submitted to the Commission for approval and that the Commission "must be guided by the overriding concern of implementing the policies of PURPA." *Milesburg II* at 1350.

In *Milesburg II*, the Court recognized that the project was entitled to receive a recalculated rate based on a later in-service date. It held that the rate would not exceed West Penn's avoided costs. The Court did not require any consideration for the recalculation. The Court noted that in permitting a recalculation of the capacity rate to reflect the later in-service date, it was, in effect, maintaining the status quo. *Id.* at 1350. As a QF, Mon Valley is entitled to a rate that does not exceed West Penn's

avoided costs. It is not required to offer consideration for that to which it is entitled.

3. Recommendation.

Mon Valley is correct.

## VII. CONCLUSIONS OF LAW

(No party objected to the proposed conclusions of law offered by Mon Valley. The Conclusions of Law set forth below, as amended, are taken from those offered by Mon Valley.)

1. The Commission has jurisdiction over the subject matter of and the parties to this proceeding.

2. Regulatory litigation delays related to the Mon Valley EEPA were unforeseeable at the time the EEPA was signed and were not caused by Mon Valley.

3. The Mon Valley project is a qualifying facility as defined in the Federal Energy Regulatory Commission's regulations. 18 CFR 292.205(a) and 292.206.

4. The Pennsylvania Public Utility Commission is empowered to modify an EEPA to ensure that it conforms with the regulations of the Federal Energy Regulatory Commission and the goals and provisions of the Public Utility Regulatory Policies Act.

5. PURPA was enacted by Congress to reduce the nation's reliance on foreign oil and to encourage the use of domestic fuel sources, including coal.

6. Section 210 of PURPA was designed by Congress to promote the development of cogeneration facilities and small power production facilities.

7. Modificaiton of the milestone dates contained in the Mon Valley EEPA ensures that the EEPA conforms with the regulations of the FERC and the goals and provisions of PURPA by preventing the termination of the

EEPA and encouraging the development of a cogeneration facility.

8. Modification of the Mon Valley EEPA to allow the use of a pulverized coal boiler with a scrubber ensures that the EEPA complies with the regulations of the FERC and the goals and provisions of PURPA by allowing more expeditious construction of the project.

9. Modification of the Mon Valley EEPA to allow a financing term of up to 20 years ensures that the EEPA complies with the regulations of the FERC and the goals and provisions of PURPA by reducing the initial principal and interest payments to be made by Mon Valley and thus, facilitating the project in its early stages.

10. The use of the extended earliest in-service date as the basis for determining the capacity rate will not change West Penn's avoided costs.

11. Modification of the Mon Valley EEPA to allow Mon Valley to assign the EEPA to Mon Valley Energy Limited Partnership, a partnership having as its general partners Mon Valley Energy Corporation and CMS Generation Mon Valley Co., a wholly owned subsidiary to be formed of CMS Generation Company as set forth in Mon Valley's Self-Certification Notification, would enable CMS Generation, through a subsidiary, to become an active, formal participant with Mon Valley in the Shannopin Project, will benefit the project from a financing, engineering, and operational standpoint and will thus satisfy the regulations of the FERC and the goals and provisions of PURPA.

## VIII. RECOMMENDED ORDER.

Therefore;

IT IS ORDERED:

1. That the Petition for Modification of an Electric Energy Purchase Agreement filed at Docket No. P-880286 by Mon Valley Energy Corporation is granted.

2. That the Electric Energy Purchase Agreement between Mon Valley Energy Corporation and West Penn Power Company relating to the Shannopin Mine Project, dated as of October 15, 1987, is modified as follows:

a. the Financing Closing Date Deadline is changed from 12/01/90 to 12/01/92 or six (6) months after a non-appealable order, whichever is later;

b. the Earliest InterConnection Date is changed from 03/01/92 to 03/01/94 or twenty-one (21) months after a non-appealable order, whichever is later;

c. the Earliest Commencement Date is changed from 09/01/92 to 09/01/94 or twenty-seven (27) months after a non-appealable order, whichever is later;

d. the dates on which monthly payments are required due to a late Commencement Date are changed from 09/01/93 and 09/01/94 to 09/01/95 and 12/01/95 or thirty-nine (39) months after a non-appealable order, whichever is later;

e. the Latest Commencement Date is changed from 03/01/95 to 03/01/96 or forty-five (45) months after a non-appealable order, whichever is later;

f. the Good Faith Deposit Dates are changed from 05/01/90, 7/02/90 and 10/01/90 to 05/01/92, 07/02/92 and 10/01/92 or one (1), three (3), and five (5) months after a non-appealable order, whichever is later;

g. the Project in-service date used as a basis for the capacity rate is changed from 09/01/92 to 09/01/94 or twenty-seven (27) months after a non-appealable order, whichever is later;

h. the financing term is changed from up to 15 years to up to 20 years;

i. the boiler is changed from a circulating fluidized bed boiler to a pulverized coal boiler with a dry scrubber; and

j. the assignment by Mon Valley Energy Corporation is changed from being limited to the lender to permitting assignment to Mon Valley Energy Limited Partnership.

3. That, under Article II of the Agreement referred to in Paragraph 2 of this order, West Penn Power Company is entitled to review the pulverized coal boiler and scrubber designs that Mon Valley Energy Corporation intends to use in the Shannopin Program.

4. That within 30 days from the date of the review referred to in paragraph 3 of this order, West Penn Power Company and Mon Valley Energy Corporation cooperate with each other and reach agreement on other changes in the EEPA related to the modification referred to in paragraph 2(i) of this order.

Date: April 29, 1991

/s/ Larry Gesoff
LARRY GESOFF
Administartive Law Judge

**APPENDIX T**

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting held August 29, 1991

Commissioners Present: William H. Smith, Chairman
Joseph Rhodes, Jr.,
Vice Chairman
Wendell F. Holland,
Commissioner
David W. Rolka, Commissioner

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE SHANNOPIN MINE PROJECT; ORDER ON PETITION OF MON VALLEY ENERGY CORPORATION FOR MODIFICATION OF ELECTRIC ENERGY PURCHASE

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## OPINION AND ORDER

BY THE COMMISSION:

Before us for consideration is the Recommended Decision of Administrative Law Judge Larry Gesoff (ALJ) on the petition for modification of electric energy purchase agreement (EEPA) of Mon Valley Energy Corporation (Mon Valley). Exceptions and reply exceptions to the Recommended Decision have been filed by the various parties. For the reasons stated more fully below, we will adopt the Recommended Decision of ALJ Gesoff and deny all the exceptions.

BACKGROUND

Mon Valley and West Penn Power Company (West Penn) executed an EEPA for the Shannopin Mine Project (Shannopin) in October 1987. Mon Valley is the developer of the Shannopin Mine Project. Shannopin is an 80 MW coal-fired cogeneration plant to be located at Poland Mines in Greene County.

In January 1988, West Penn filed a petition for rate recovery approval of amounts proposed to be paid under the Shannopin EEPA. At about the same time, West Penn filed two similar petitions pertaining to a proposed 5 MW hydroelectric project (Monongahela Lock & Dam No. 8) and a proposed 80 MW waste coal-fired project (Burgettstown).

The Commission, through a tentative order entered July 8, 1988, granted all three petitions. Shortly thereafter, the Commonwealth Court issued its *Milesburg I* decision which under the facts of that case required an opportunity to be heard prior to approval of utility purchases. *Barasch v. Pa. P.U.C.*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296, reargument granted in part 119 Pa. Commonwealth Ct. 118, 550 A.2d 257 (1988) (*Milesburg I*).

In response to *Milesburg I*, the Commission consolidated its proceedings for Milesburg, Burgettstown, Shannopin and Monongahela Lock & Dam. The Commission ordered notice to be given by way of bill insert and assigned the consolidated matter to the Office of Administrative Law Judges (OALJ) for hearing and a recommended decision. This resulted in a Commission order entered September 29, 1989.

The Commission order was divided into two parts. Phase I of the order approved the rates in the various EEPAs based, in part, on West Penn's avoided cost projections in effect when the rates were negotiated. Phase

II granted the Milesburg and Burgettstown requests for modification to their EEPAs to compensate for litigation delays. The Commission extended the Milesburg EEPA milestone dates and increased Milesburg's capacity credit to reflect the delayed in-service date. For the Burgettstown project, the Commission only extended the milestone dates because Burgettstown had withdrawn an earlier request for modification of its capacity credit. Mon Valley had not requested Phase II type modifications for the Shannopin project at that time because its EEPA had a later in-service date.

The issues raised by Mon Valley's petition are nearly identical to the issues raised by Phase II of the Milesburg and Burgettstown proceedings which were decided by the Commission in September 1989. *See Petitions of West Penn Power Company Re: Milesburg Energy, Inc., Monongahela Lock & Dam No. 8, Burgettstown Project and Shannopin Mine Project,* 71 Pa. P.U.C. 60, 106 PUR 4th 459 (September 29, 1989). Phase I of the Commission's September 1989 order resolved *rate* issues raised by the EEPAs for Milesburg, Burgettstown and Shannopin. Phase II of the Commission's order resolved EEPA *modifications* requested by Milesburg and Burgettstown arising from litigation delays.

As noted above, because its EEPA was based on a later in-service date than either Milesburg or Burgettstown, Mon Valley had not requested an EEPA modification at that time. However, as litigation of the proceedings dragged on through appeals to the Commonwealth Court and subsequent petitions for allowance for appeal with the Pennsylvania Supreme Court, the litigation delays also threatened the Shannopin EEPA. Therefore, Shannopin filed its Phase II petition for modification on April 20, 1990.

The September 1989 Commission order granted the modifications requested by Milesburg and Burgettstown. The Commission held that litigation delays should not be

permitted to cause the failure of a QF project. As we stated in that order, to allow the EEPA to terminate as a result of regulatory and litigation delay "would merely extend an open invitation to interventions in opposition to future QF proceedings since intervenors would realize that they could win by default, through the passage of time alone, results that could not be won on the merits." 71 Pa. P.U.C. at 80; 106 PUR4th at 478. Our reasoning regarding Milesburg and Burgettstown remains valid when applied to Shannopin. It is essential that this Commission try to prevent litigation delays from thwarting the development of QFs in Pennsylvania.

Commonwealth Court supports this view. The Court has affirmed Phase II of the Commission's September 1989 order. *Armco Advanced Materials Corp. v. Pa. P.U.C.*, 135 Pa. Commonwealth Ct. 15. 579 A.2d 1337 (1990) (*Milesburg II*). The Court stated that "[i]n our view, the PUC has full discretion in the exercise of its power under PURPA and the FERC regulations to encourage the development of cogeneration and small power production to ensure that litigation delays do not become the factor that determines whether a project proceeds or fails." 579 A.2d at 1349-50.

DISCUSSION

The ALJ applied the Commission's philosophy regarding litigation delays and encouragement of the development of qualifying facilities (QF) in Pennsylvania to Mon Valley's petition for modification and recommended that the petition be granted. The ALJ recommends that the financing closing date, set forth in the Shannopin EEPA, be extended to the later of six months after the issuance of a final Commission order on Phase I or December 1, 1992 with corresponding adjustments to related milestones. The ALJ also recommends that the capacity rate be increased to reflect the delays in Shannopin's in-service date. These recommendations are nearly

identical to Phase II of the Commission's September 29, 1989 order regarding Milesburg and Burgettstown. In addition, the ALJ recommends that the EEPA be amended to permit a change in boiler design, a longer (20-year) financing term and a change in assignment provisions.

Exceptions were filed by Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), West Penn and the Office of Consumer Advocate (OCA). While these exceptions raise little that was not considered by the Commission when it granted the contract modifications requested by Milesburg and Burgettstown two years ago, they will be discussed nonetheless.

(a) Jurisdiction

West Penn and Armco/Allegheny resurrect their arguments that the Commission lacks jurisdiction to modify power purchase agreements. The ALJ cited the Commission's determination of jurisdiction as set forth in its order of May 10, 1990 which granted Mon Valley's stay and concluded that the Commission has the jurisdiction to hear and dispose of Mon Valley's petition to modify. Both West Penn and Armco/Allegheny stressed that the Commission does not have the power, under PURPA, to modify the terms of a voluntarily negotiated EEPA. Both parties also incorporate arguments raised in the past that the Commission lacks jurisdiction due to pending court appeals.

In its reply exceptions, Mon Valley argued that there is clear precedent for Commission ordered modification of the EEPA. Mon Valley asserts that West Penn and Armco/Allegheny's exceptions ask the Commission to ignore *Milesburg II*.

The ALJ and Mon Valley are correct. The Commonwealth Court has confirmed the Commission's authority to grant modifications to EEPAs. *Milesburg II*, 579 A.2d 1337. Furthermore, once it is determined that the Com-

mission has jurisdiction over a matter, an appeal pertaining to wholly separate issues will not suspend it. Therefore, West Penn's and Armco/Allegheny's exceptions are denied.

(b) Litigation Delays Justify Modification

The ALJ examined whether *Milesburg II* and *Burgettstown* [1] were controlling in this proceeding. He determined that while those cases did not mandate approval of all requested modifications, they do "approve of Commission modifications to an EEPA to save a project threatened by litigation delays." Recommended Decision at 24-25. The ALJ noted that as far as the requested modifications related to litigation delays, "[t]he same regulatory litigation delays that justified modification of the Milesburg and Burgettstown EEPAs justified modification of Mon Valley's EEPA." Recommended Decision at 21.

West Penn and Armco/Allegheny excepted to this ALJ finding. West Penn claims that litigation delays do not justify modification to the EEPA because rates in Shannopin's EEPA exceed West Penn's *current* projected avoided costs. West Penn's attempt to refocus the proceeding to its current avoided cost projections is irrelevant because the Commonwealth Court has ordered that the correct projections under § 210 of the Public Utilities Regulatory Policies Act (PURPA) are those in effect when the EEPA was signed.[2]

West Penn further claims that the ALJ erroneously blames the utility for litigation delays and characterizes the Recommended Decision as punishment. The ALJ

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[1] *Armco Advanced Materials Corp. v. Pa. P.U.C.*, Nos. 2090 and 2097 C.D. 1989 (September 7, 1990) (*Burgettstown*).

[2] The Commission's policy of using projections in effect when a QF contract rate was negotiated was reversed by the Commonwealth Court. The Court, however, rejected West Penn's argument that current avoided cost projections should be utilized. These issues are now on appeal before the Pennsylvania Supreme Court.

was correct when he stated that West Penn has played a prominent part in delaying the Shannopin Project. For example, West Penn petitioned the Supreme Court for appeal of the Commonwealth Court's Shannopin decision raising Phase II issues even though Shannopin pertained only to the Phase I (time frame) issue. The ALJ's Recommended Decision does not punish West Penn for creating litigation delays. Rather, the Recommended Decision merely reflects the Commission's policy as expressed in its September 29, 1989 order of not permitting litigation delays to kill QF projects.

West Penn further argues that the test set forth in 18 C.F.R. § 292.304(a) should have been applied. The regulation referred to pertains to avoided cost rates. The rate issues have been decided and are now before the Pennsylvania Supreme Court for review. Rates are simply not an issue in this proceeding. For the reasons stated above, West Penn's exception is denied.

In its exception, Armco/Allegheny disagree with the ALJ's finding that the inability of the project to meet the milestone dates is due to litigation delays. Armco/Allegheny Exceptions at 29-35. This argument is erroneous. The proceeding for rate recovery approval began in January 1988. Armco/Allegheny had impeded this project through litigation and appeals since that time. Project financing is impossible without a final and non-appealable Commission order approving rate recovery under the EEPA. The fact that Mon Valley waited to file applications for environmental permits is not relevant. By February 1988 when Armco/Allegheny intervened and opposed the project, it was already clear that a final Commission order would be delayed. Armco/Allegheny's exception is denied.

(c) Project Meets PURPA Objectives

In excepting to the ALJ finding that the Shannopin Project meets PURPA requirements, Armco/Allegheny

argue that the current need for capacity should be considered. Armco/Allegheny claim that modifications should be denied because West Penn's current capacity needs are, according to Armco/Allegheny, zero.

Armco/Allegheny's exception attempts to raise rate issues in this proceeding. As stated above, the rate issues (Phase I issues) have been decided by the Commission's order of September 29, 1989 which subsequently was modified by the Commonwealth Court. The Court held that Shannopin's EEPA rates should be changed to reflect West Penn's avoided costs projections as of October 1987 when the EEPA was signed. As previously stated, the rate issue is outside the scope of this proceeding. Moreover, adopting Armco/Allegheny's argument would violate the Commonwealth Court's order. As such, Armco/Allegheny's exception is denied.

(d) Milestone Extensions

West Penn excepted to the ALJ's extension of milestone dates arguing that Shannopin's situation is vastly different from Milesburg and Burgettstown. As Mon Valley pointed out in its reply exceptions, the ALJ considered the differences between the projects but concluded that the situations were sufficiently similar. We agree. The delays facing Shannopin arise from the very same litigation facing Milesburg and Burgettstown. Therefore, West Penn's excepton is denied.

(e) Extended In-Service Date and Recalculation of Rate

West Penn argues that the recommended decision mischaracterizes some testimony regarding West Penn's avoided cost methodology. The ALJ's recommended decision is clear on the point that extending the in-service date for the purpose of calculating the capacity credit does not change West Penn's avoided costs. Recommended Decision at 36-43. In its reply exceptions, Mon Valley argues that the ALJ recommended the same type

of relief the Commission gave the Milesburg project. 71 Pa. P.U.C. at 83, 106 PUR 4th at 481. The Commonwealth Court later upheld the Commission on this issue in *Milesburg II*, 579 A.2d 1337.

The OCA excepts to the use of a new milestone date in recalculating the current capacity rate. The OCA states that it is not proper to change this element in the capacity rate calculation while issues relating to the recalculation of original capacity are on appeal.

This issue was raised in *Milesburg II* and decided by the Commonwealth Court in favor of the change to Milesburg's in-service date in the capacity credit calculation. *Id.* This Commission has held that there is no inconsistency with reflecting a project's later in-service date in the calculation under West Penn's methodology. 71 Pa. P.U.C. at 83, 106 PUR4th at 481. In that order, we expressly stated:

> All of the inputs regarding West Penn's avoided costs will remain the same. The in-service date is not a component of West Penn's avoided costs or the costs of the . . . unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's avoided *costs* do not change with changes in a project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

*Id.* The Commonwealth Court agreed with the Commission's finding, approving the Commission's compensation for the fact that the capacity credit would have been higher, to better match actual capacity needs of the utility, if the parties had anticipated a later in-service, as simply one aspect of efforts to approve a contract that has not been altered to the detriment of the QF by delays resulting from litigation. 579 A.2d at 1350. For these reasons, the exceptions of West Penn and OCA are denied.

(f) Extending Financing Term

West Penn excepts to the ALJ's recommendation to extend Shannopin's financing term from 15 to 20 years because "there is nothing definitive in the record to support the need for, or the propriety of, a 20 year financing term". West Penn Exceptions at 10-11. Mon Valley had requested an EEPA modification allowing it to seek a 25-year financing term. Testimony in the records supports a finding that increasing the financing term reduces the project's initial debt service making the project more attractive to investors. The ALJ determined that reducing the initial amounts of principal and interest the project must pay reduces the risk to the ratepayers that the project will fail. This finding is applicable to an increased financing term of 20, as well as 25 years. Therefore, West Penn's exception is denied.

West Penn also excepts to that portion of the recommended decision which would permit a change in project ownership from Mon Valley to Mon Valley Limited Partnership, with the general partners, Mon Valley Energy Corporation and CMS Generation Company (CMS). West Penn argues that it has not had an opportunity to review the documentation associated with the assignment. Mon Valley acknowledges West Penn's right under the EEPA to review the documentation but argues that West Penn had not responded to past requests to consider the assignment. Mon Valley Reply Exceptions at 15.

Although Mon Valley raised this issue for the first time in its brief, the ALJ recommends granting the request. In his recommended decision, the ALJ noted that "formal involvement of CMS will benefit the project by providing the financial and technical support of a utility subsidiary". Recommended Decision at 51-52. The ALJ further noted that involvement of CMS would not affect the contract itself and should benefit all parties. Moreover, in QF development, changes in project ownership are the rule rather than the exception. We agree with the

ALJ's assessment of the change in project ownership and hence deny West Penn's exception.

(g) Effect of Modifications

Armco/Allegheny except to the ALJ's finding that the requested modifications are consistent with PURPA and the FERC regulations. Specifically, Armco/Allegheny state that the modifications requested by Mon Valley transformed the EEPA into a new EEPA; thereby requiring a new determination of avoided costs. Armco/Allegheny Exceptions at 22-25. This same argument was made by Armco/Allegheny and West Penn before the Commonwealth Court in *Milesburg II* and *Burgettstown*. The Court rejected the argument and held that the Commission had the full power and duty to examine all of the EEPA's terms to insure that they are compatible with the goal of section 210 of PURPA to encourage cogeneration and small power production. 579 A.2d at 1349-50. As Mon Valley noted in its reply exceptions, none of the requested modifications affect the legally enforceable obligation that Mon Valley accepted. Mon Valley Reply Exceptions at 24. The only real distinction between the instant proceeding and *Milesburg II* and *Burgettstown* is that the Phase II issues of the Milesburg and Burgettstown Projects were considered at the same time that the rate issues were considered while Shannopin's Phase II issues are being separately decided. Armco/Allegheny's exception is denied.

(h) Imposition of Planning Risks

West Penn argues that granting Mon Valley's requested modifications would impose serious planning risks on West Penn. West Penn further avers that the modifications are so extensive that they would, in effect, create a new EEPA.

West Penn has made this same argument in Phase II proceedings for the Milesburg and Burgettstown Projects.

The Commission rejected this argument in that case. As we stated then, failure to grant an extension would leave an 80 MW shortfall in West Penn's generation plans. 71 Pa. P.U.C. at 80. Attempting to account for this shortfall by beginning the contract negotiation process anew would only add to the uncertainty because the new contract not only would likely face continuing opposition, but also would encounter a Commission policy against compensating for regulatory dely. *Id.* Allowing projects to die in litigation "would inject the very uncertainty in West Penn's generation plans that it seeks to avoid." *Id.* The Commission's order later was affirmed by the Commonwealth Court. 579 A.2d 1337. West Penn is attempting to relitigate issues it has already raised and lost. The argument that the modifications create a new EEPA has been addressed above. West Penn's exception is denied.

(i) Milestone Extensions Do Not Violate PURPA

West Penn argues that any milestone extensions ordered by the Commission should be no later than the scheduled 1995 in-service date of West Penn's avoided capacity. The ALJ was correct when he noted that "West Penn treats the planned in-service date of its avoided capacity as a precise date rather than a projection, which is its true nature." Recommended Decision at 68. Moreover, to extend milestones by dates certain would be tantamount to encouraging utilities and intervenors to employ additional dilatory tactics until those certain dates passed. West Penn's exception is denied.

(j) Shannopin is a QF

West Penn and Armco/Allegheny except to the ALJ's finding that Shannopin is a QF. These exceptions are without merit. Actual FERC certification is not relevant under section 210 of PURPA. So long as a facility meets the definition of a QF, it *is* a QF regardless of whether

FERC certifies a facility as qualified. These exceptions are denied.

(k) Emergency Order

Armco/Allegheny except to the ALJ's finding that it does not have standing to challenge the April 27, 1990 emergency order. The ALJ incorporated by reference the Commission's reasoning in its May 10, 1990 order ruling that Armco/Allegheny did not have standing to protest the grant of the stay. Armco/Allegheny argue that the Commonwealth Court held, in *Burgettstown*, that Armco/Allegheny had standing on milestone extension issues in addition to rate issues because the "determination of the propriety of the milestone extensions will have the effect of deciding whether [Burgettstown] proceeds or whether it terminated automatically. . . ." Nos. 2090 and 2097 C.D. 1989 (September 7, 1990).

Armco/Allegheny correctly cites to *Burgettstown* which was issued after the Commission's May 10, 1990 order. However, *Burgettstown* may not be determinative of this particular issue. The Commonwealth Court did not address the issue of whether industrial customers would have standing to object to *stays* of contract provisions as opposed to *modifications* of contract provisions. The effect of a stay is simply to continue the status quo. In no way did the stay, in this case, determine whether the modification ultimately would be granted.

We are of the opinion that *Burgettstown* does not apply to stays of contract provisions. The granting of a stay until modification issues have been decided will not affect the ultimate outcome. Armco/Allegheny had full opportunity to oppose the modifications and protect their interests. Their lack of standing to oppose the stay had no effect on their rights to oppose the contract modifications. Armco/Allegheny's exception is denied.

(1) Miscellaneous

West Penn excepts to the ALJ's order striking West Penn's testimony regarding its current avoided cost projections. The ALJ's ruling was correct. The Commonwealth Court has established the EEPA signing date, October 15, 1987, as the relevant time frame for establishing West Penn's avoided costs. As stated above, projections in effect at other times simply are not relevant. This exception is denied. West Penn excepts to the fact that the ALJ has issued a recommended decision at this time. West Penn argues that the Commission should defer making a decision in this proceeding until litigation related to Phase I issues is concluded. The ALJ was correct in noting that the issues in this proceeding are ripe for decision, regardless of the outcome of Phase I appeals. Recommended Decision at 55. To defer a decision on Phase II issues until Phase I appeals have concluded would merely delay the project further. This is especially true since appeals of this Phase II order are possible. This exception is denied.

West Penn claims that the ALJ characterized the facts and conclusions proposed by Mon Valley as unopposed and asserts that the ALJ failed to consider West Penn arguments which questioned those facts and conclusions. The ALJ's language is correct—no party did object to Mon Valley's proposed findings of fact and conclusions of law. While the ALJ noted that no formal objections were filed, he certainly did not ignore West Penn's arguments which questioned certain facts and conclusions. The ALJ considered West Penn's version of facts as he weighed the company's arguments. The ALJ revised Mon Valley's proposed facts and conclusions so they conform to the evidence of record. This exception is meritless and hence denied.

Armco/Allegheny argue that granting the requested modifications would set a dangerous precedent by calling into question "the finality of all of the Commission's

PURPA orders". Armco/Allegheny Exceptions at 38-39. It is precisely because the Commission's Shannopin order is *not* final that the modifications to reflect litigation delays are necessary. The far greater danger would be to allow Armco and Allegheny to win their case, thereby defeating three QF projects, by endless litigation alone. As stated above, it is essential that the Commission attempt to prevent litigation delays from thwarting the development of QF's in Pennsylvania. This exception is denied.

## CONCLUSION

The general theme running through the exceptions to the ALJ's recommended decision is that the capacity from the Shannopin project is no longer needed and that the project now represents a financial detriment to West Penn's ratepayers. The Commonwealth Court has ruled that the October 1987 projections are controlling and that Phase I (time frame) issues are not at issue in this Phase II proceeding.

The Shannopin EEPA, as well as the Milesburg and Burgettstown EEPA's, were based on West Penn's 1986 determination that it needed additional baseload capacity in 1995. On this basis, all three projects in good faith negotiated EEPA's and expended large sums toward project development. Since that time, we can see nothing of significance that would have decreased West Penn's need for additional capacity. The PURPA baseload capacity that would be provided by Shannopin, Milesburg and Burgettstown was, in West Penn's judgment in 1986, needed by the utility. Its current projections will not affect that.

For the above stated reasons, the recommended decision of Administrative Law Judge Larry Gesoff is adopted and the exceptions filed in this proceeding are denied.

THEREFORE, IT IS ORDERED:

1. That the petition for modification of an electric energy purchase agreement filed at Docket No. P-880286 by Mon Valley Energy Corporation is granted.

2. That the Electric Energy Purchase Agreement between Mon Valley Energy Corporation and West Penn Power Company related to the Shannopin Mine Project dated October 15, 1987 is modified as follows:

a. The Financing Closing Date deadline is changed from December 1, 1990 to December 1, 1992 or six (6) months after a non-appealable order, whichever is later.

b. The Earliest Interconnection Date is changed from March 1, 1992 to March 1, 1994 or twenty-one (21) months after a non-appealable order, whichever is later.

c. The Earliest Commencement Date is changed from September 1, 1992 to September 1, 1994 or twenty-seven (27) months after a non-appealable order, whichever is later.

d. The dates on which monthly payments are required due to a late Commencement Date are changed from September 1, 1993 and September 1, 1994 to September 1, 1995 and December 1, 1995 or thirty-nine (39) months after a non-appealable order, whichever is later.

e. The Latest Commencement Date is changed from March 1, 1995 to March 1, 1996 or forty-five (45) months after a non-appealable order, whichever is later.

f. The Good Faith Deposit dates are changed from May 1, 1990, July 2, 1990 and October 1, 1990 to May 1, 1992, July 2, 1992 and October 1, 1992 or one (1), three (3) and five (5) months after a non-appealable order, whichever is later.

g. The Project in-service date used as a basis for the capacity rate is changed from September 1, 1992 to September 1, 1994 or twenty-seven (27) months after a non-appealable order, whichever is later.

h. The financing term is changed from up to 15 years to up to 20 years.

i. The boiler is changed from a circulating fluidized bed boiler to a pulverized coal boiler with a dry scrubber.

j. The assignment by Mon Valley Energy Corporation is changed from being limited to the lender to permitting assignment to Mon Valley Energy Limited Partnership.

3. That under Article II of the Agreement referred to in Paragraph 2 of this order, West Penn Power Company is entitled to review the pulverized coal boiler and scrubber designs that Mon Valley Energy Corporation intends to use in the Shannopin project.

4. That within 30 days from the date of the review referred to in Paragraph 3 of this order, West Penn Power Company and Mon Valley Energy Corporation shall cooperate with each other and reach agreement on other changes in the EEPA related to the modifications referred to in Paragraph 2(i) of this order.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: August 29, 1991

ORDER ENTERED: January 14, 1992

**APPENDIX U**

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting held November 27, 1991

Commissioners Present: William H. Smith, Chairman
Joseph Rhodes, Jr.,
Vice Chairman
Wendell F. Holland,
Commissioner
David W. Rolka, Commissioner

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE: SHANNOPIN MINE PROJECT

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OPINION AND ORDER ON REMAND

BY THE COMMISSION:

The issue before us for consideration in this part of the proceedings at Docket No. P-880286 concerns the petition of Mon Valley Energy Corporation (Mon Valley) for recalculation of capacity cost credit, which petition was filed on May 8, 1991. The immediate petition in essence requests that the Commission implement the order of Commonwealth Court dated July 17, 1990, which remanded the proceedings to the Commission for consideration of a change in the appropriate tax rate to be used in the capacity cost rate calculation. Overall, the question

of a West Penn Power Company (West Penn) purchase of electric energy from the Shannopin Mine Project, a qualifying facility to be developed by Mon Valley, has had a long and tortured history before the Commission and appellate courts. Our action today should help end this controversy and allow development of the project to proceed.

After having negotiated with Mon Valley for a substantial period of time, West Penn entered into an electric energy purchase agreement (EEPA) with Mon Valley, under date of October 15, 1987. That agreement contained price terms that were derived prior to the October 15 date endorsed upon the contract. On January 20, 1988, West Penn filed with the Commission a petition seeking an order that West Penn could pass through to its ratepayers all costs incurred under the agreement. On July 8, 1988, we issued a tentative order granting approval of the rates in the Mon Valley contract and energy cost rate (ECR) recovery of such rates from West Penn ratepayers. However, after adoption of that tentative order, the Commonwealth Court entered its order in *Barasch v. Pa. P.U.C.*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*Milesburg I*). The Court required, in *Milesburg I*, that where purchases of capacity from a qualifying facility involve substantial payments for such capacity, at least the "essential elements" of a hearing on the contract should be provided if requested by an affected party. Therefore, we consolidated the question of approval of the purchase from Mon Valley with the Milesburg proceedings and those involving purchases from several other qualifying facilities.

By order entered September 29, 1989, after hearings on the consolidated proceedings, the Commission approved the EEPA between Mon Valley and West Penn and recovery of such costs through the ECR. In the proceedings leading up to that order, Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), two industrial customers of West Penn, had

raised issues relating to the time of calculation of the capacity payment to be made to Mon Valley. Armco/Allegheny appealed the Commission's final order of September 29 to Commonwealth Court. One of the issues raised by Armco/Allegheny, was the contention that the capacity cost calculation was improper because it used tax rates in effect at the time of "serious negotiation" (which the Commission had adopted as its standard), rather than tax rates in effect on the date borne by the contract, i.e. October 15, 1987.

With regard to the time of calculating the capacity payment, Armco/Allegheny asserted on appeal only that the improper tax rate had been used. The Court recognized that in its order:

> The dispute in this case concerns only one input—applicable corporate tax rates—to be used in calculating FAC. A calculation of FAC employing the method accepted by all the parties, but using the legally proper tax rates, will address the concerns raised by appellant Armco/Allegheny.

Slip Opinion, p. 10. The Court directed that the case be remanded to the Commission and instructed that we calculate West Penn's full avoided cost according to West Penn's method but using tax rates in effect on the date which appears on the contract.[1]

A petition for allowance of appeal from the Commonwealth Court order was filed with the Supreme Court of Pennsylvania by West Penn, at No. 545 Allocatur Docket 1990. Cross-petitions for allowance of appeal were filed by the Commission and Mon Valley. Prior to Commonwealth Court issuing its opinion and order, Mon Valley filed a petition for modification of the EEPA, on April 20, 1990, requesting that the capacity cost credit be cal-

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[1] West Penn had also appealed the Commission's opinion and order, but the West Penn appeal concerned issues not germane to this order.

culated as of a later in-service date. That request was made necessary due to litigation delays. Mon Valley also requested, at that time and subsequently, extensions of certain due dates. Commonwealth Court subsequently approved similar modifications in *Armco Advanced Materials Corp. v. Pa. P.U.C.*, —— Pa. Commonwealth Ct. ——, 579 A.2d 1337 (1990) (*Milesburg II*). Those modifications and extensions of the Mon Valley EEPA were approved by Administrative Law Judge Gesoff and the Commission adopted that ALJ's recommended decision.[2]

The Pennsylvania Supreme Court had not acted on the various petitions for allowance of appeal, so on May 8, 1991, Mon Valley filed with this Commission its petition for recalculation of the capacity cost credit, i.e., implementation of the Commonwealth Court remand directive, which is the subject of this order. In its petition, Mon Valley alleged that the continuing delay of these proceedings, particularly the delay in performing this calculation, would impede the development of the project. Mon Valley requested that the Commission direct interested parties to submit proposed rate recalculations, using the West Penn methodology as contemplated by the Commonwealth Court, and including all inputs used in the recalculation. Of course, these recalculations should be made only based on the tax law changes, as provided by the Commonwealth Court order.[3] Mon Valley also asked that the calculations be made reflecting different in-service dates as of September 1, 1992 and for each quarter thereafter. Mon Valley further suggests that interested parties then be given the opportunity to file responses to the recalculations of other parties.

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[2] The order adopting the recommended decision has not been entered as of the date of the instant order.

[3] Both the federal and Pennsylvania tax rates were changed effective in 1987, so tax changes will include both federal and state taxes.

On May 23, 1991, Armco/Allegheny filed an answer to the Mon Valley petition and a motion to dismiss the Mon Valley petition. The answer denies that Armco/Allegheny only argues for tax rate changes in the capacity payment recalculation. Armco/Allegheny refers to the Commonwealth Court's order which indicates that the recalculation shall relate to factors in existence at the October 15, 1987 date and cites that for the proposition that all factors should be changed. The answer also asserts that the Commission could not proceed to implement the Commonwealth Court order until the Supreme Court of Pennsylvania determined whether it would allow the appeals. The Armco/Allegheny motion to dismiss goes into extensive detail about the Mon Valley request for modification. The motion also goes into extensive detail about how the proceedings before ALJ Gesoff did not delve into West Penn's current avoided costs or 1987 avoided costs. Of course, that proceeding was separate from the instant matter and was not intended to implement the Commonwealth Court's order. The changes in due dates and calculations made necessary due to a later on-line date, which in turn was made necessary by litigation initiated and pursued by Armco/Allegheny, of course did not involve the same subject matter as the previous appeal or the consequent Commonwealth Court remand. That remand, however, is the subject of the instant proceeding.

On May 28, 1989, West Penn filed a Motion to Dismiss and Answer to the Mon Valley Petition. Essentially West Penn also claimed the Commission could not implement the Commonwealth Court order and claimed Mon Valley's position was inconsistent with that advanced before ALJ Gesoff.

On June 5, 1991, Mon Valley filed a response to the Armco/Allegheny motion to dismiss and a brief in support of that response.

On November 21, 1991, the Supreme Court of Pennsylvania denied the petition for allowance of appeal filed

by West Penn and the cross-petition for allowance of appeal filed by the Commision, thus effectively terminating the appeal from the Commonwealth Court decision.

## DISCUSSION

Both Armco/Allegheny and West Penn, in their motions to dismiss, have asserted that the Commission lacks "jurisdiction" to implement the direction contained in the Commonwealth Court order. Armco/Allegheny and West Penn's position is wholly incorrect as a plain reading of the Rules of Appellate Procedure demonstrates and logic compels. Pa. R.A.P. 1701(a) provides that a government unit may not proceed "further in the matter," after an appeal has been taken, "except as otherwise prescribed by these rules. . . ." Pa. R.A.P. 1701(b)(2) provides that the agency may enforce any order entered in the matter unless the effect of that order has been superseded as prescribed in the appellate rules, and 1701(b)(5) provides that the agency can take any action directed or authorized by the appellate court. West Penn and Armco/Allegheny cite a number of cases for the proposiiton that an agency or lower court cannot "proceed further" in a matter after an appeal is taken. But of course what the general provisions of Pa. R.A.P. 1701(a) mean is that, as far as disputed matters are concerned, there should be no further proceedings such as hearings, further orders, etc. during the pendency of the appeal.

There are two broad issues involved here, one being the general authority of the Commission to take further actions after an appeal of its order, the second being the degree to which enforcement of either the Commission's order or the subsequent order of an appellate court is precluded. Of course the way one "precludes" enforcement of an order is to obtain a supersedeas of it. The appellate rules provide generally for supersedeas at Pa. R.A.P. 1731-1782, with Pa. R.A.P. 1781 and 1782 pertaining particularly to review of governmental agency determinations.

Since 1701(b) specifically lists among the powers retained by the agency or lower court the power to enforce orders not superseded and the requirement to take any action authorized by the appellate tribunal, it is clear that the Commission is not deprived of jurisdiction over this matter. Of course logic compels this conclusion as well, since were the Commission or a court deprived of jurisdiction simply by the lodging of an appeal, supersedeas would always be automatic, and none of the provisions in the appellate rules concerning supersedeas would be necessary.

West Penn further asserts that we lack jurisdiction by claiming that Mon Valley's petition to implement the Commonwealth Court order is inconsistent with Mon Valley's position that proceedings before ALJ Gesoff should properly exclude consideration of issues specifically dealt with in the Commonwealth Court order, as well as excluding 1987 avoided cost calculation issues clearly not before the Commonwealth Court when it rendered its decision. We see no inconsistency in Mon Valley's position; clearly, the issue of extension of due dates and changes due to litigation delays concerns one set of issues, while implementation of the Commonwealth Court's remand directions (the matter before us here) involves entirely different issues. Therefore we will deny the motions to dismiss of Armco/Allegheny and West Penn Power, on the basis that the Commission clearly has jurisdiction to proceed herein.

The next question, however, is whether the Commission may implement the order of the Commonwealth Court or indeed whether it is required to do so. For reasons which would be dicta here, we believe that the Commission could not be compelled to implement the Commonwealth Court's remand directives, at least absent further direction to do so from Commonwealth Court, during the pendency of the Petitions for Allowance of Appeal to the Supreme Court of Pennsylvania. Though the Supreme Court has

now acted, we believe the Commission could "resist" implementing the Commonwealth Court's order at least until the record was remanded to the Commission, but there is no reason for such delay. As Mon Valley notes, no stay has been sought of the Commonwealth Court order, thus the recalculation order could have been implemented, even pending the decision on the Petitions for Allowance of Appeal. As previously indicated, Pa. R.A.P. 1781 specifically provides the procedures for obtaining a stay pending action on a petition for review and Pa. R.A.P. 1732 provides the procedure for obtaining a stay generally. Mon Valley cites *SEPTA v. ACORN*, 128 Pa. Commonwealth Ct. 310, 563 A.2d 574 (1989) for the proposition that, if a stay is denied, the Commonwealth Court order can be implemented. We agree. Since no one has even sought a stay, in our opinion the Commission has the discretion to implement the Commonwealth Court order even during pendency of the petitions for allowance of appeal.

Mon Valley, in its brief and answer responding to the West Penn motion to dismiss, clearly articulates the position that issues dealt with in the Commonwealth Court decision were not properly a part of the proceedings before ALJ Gesoff. Mon Valley concludes by asserting that it is the Commission's "responsibility" to implement the Commonwealth Court order in the absence of a stay.

Nothing in the arguments advanced by West Penn and Armco/Allegheny convinces us that we lack jurisdiction over this matter. Further, nothing convinces us that there is any reason we should not implement the directives in the Commonwealth Court remand at this time. Concerning Armco/Allegheny's contentions that it raised more than the tax rate calculations, that assertion is entirely contradicted by the brief of Armco/Allegheny presented to Commonwealth Court. Therein at pages 24-27 and page 33, Armco/Allegheny specifically and in some detail focuses on the consequences (according to it) of using federal and state tax rates in effect prior to 1987 to cal-

culate payments to Mon Valley. Use of such tax rates is *the* reason advanced by Armco/Allegheny to support its claim that the 1987 avoided cost calculations were too high. Regardless of any assertions that Armco/Allegheny may have made in proceedings before the Commission, that is the *only* item it placed before the Court concerning the recalculation, as Commonwealth Court recognized in its opinion, at page 10. We will not permit Armco/Allegheny to leverage the position it chose to advance on appeal to the Commonwealth Court into a far broader consideration than the Court directed. Finally, we note that Armco/Allegheny prevailed in Commonwealth Court and yet it is the party which most strenuously objects to implementation of the Commonwealth Court order. We hold that determinations of issues involving utility purchases from qualifying facilities must be made on the merits and the law, and that a party must not be able to prevail simply due to delay. We will grant the Petition of Mon Valley in this proceeding; THEREFORE,

IT IS ORDERED:

1. That the Petition of Mon Valley Energy Corporation for Recalculation of Capacity Cost Credit is granted. That Petition is tantamount to requesting implementation of Commonwealth Court's directions on remand, which implementation is hereby carried forth.

2. That the Answers and Motions to Dismiss the Mon Valley Petition filed by Armco/Allegheny and West Penn are denied.

3. That in accord with the Commonwealth court order, calculations of West Penn's "full avoided cost" (FAC), using West Penn's methodology but using federal and state tax rates in effect in 1987, shall be made by Mon Valley, West Penn and other affected parties and shall be submitted to the Commission within twenty (20) days of receipt of this order. Submittals should include full explanation of the calculations and assumptions.

4. That each calculation proposed in accord with paragraph three above should be made based on an in-service date of the Shannopin project as of September 1, 1992 and as of the first day of each calendar quarter beginning October 1, 1992 and thereafter through October 1, 1995.

5. That the recalculations thus submitted will become part of the record in accord with the Commonwealth Court's order. Parties shall serve the calculations upon all other parties, each of which may respond in writing thereto within twenty (20) days after receipt. Such responses shall also become part of the record.

6. That upon receipt of calculations and any responses, the Commission shall enter a final order herein.

7. That a copy of this order be served upon all parties to the proceedings at Docket No. P-880286.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

Order adopted: November 27, 1991

Order entered: December 5, 1991

## APPENDIX V

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17105-3265

Public Meeting held May 21, 1992

Commissioners Present: David W. Rolka, Chairman
Joseph Rhodes, Jr.,
Vice Chairman
Wendell F. Holland,
Commissioner

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE: SHANNOPIN MINE PROJECT

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## OPINION AND ORDER

BY THE COMMISSION:

By our opinion and order on remand, entered December 5, 1991, we drected that the parties to this proceeding should carry out the Commonwealth Court's July 17, 1990 order by submitting for our consideration calculations of payments to be made to Mon Valley Energy Corporation (Mon Valley or Shannopin) for power purchases, using West Penn Power Company's "avoided cost" methodology, but updated to reflect changes to such costs due to tax law changes in effect for October 15, 1987, the date of contract signing.

By petition dated December 23, 1991, West Penn Power Company (West Penn) has sought reconsideration of the Commission's opinion and order of December 5, 1991. By submittal dated December 30, 1991, West Penn provided its calculation of avoided costs which *it* contends reflects the appropriate changes as of October 15, 1987. Mon Valley, by submittal dated December 31, 1991, provided what *it* contends is the appropriate recalculation of the capacity rate to reflect the tax law changes effective as of October 15, 1987. Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny) submitted, on December 30, 1991, a petition for rescission and amendment of the Commission's December 5 opinion and order. Mon Valley filed responses to the West Penn and Armco/Allegheny petitions on January 6 and January 13, 1992, respectively. On January 21, 1992, Mon Valley filed a "response" to the calculations of West Penn, reflecting certain changes in the Mon Valley recalculations. Under date of February 12, 1992, Armco/Allegheny filed a "reply" to the Mon Valley recalculation "response".

*Discussion*

In its petition for reconsideration, West Penn has argued that the Commission must change its order entered December 5, 1991 to provide that the recalculation of the capacity payments to Mon Valley should reflect an "updating" of factors beyond changes in the tax law to October 15, 1987. West Penn contends that tax law changes were not the only "inputs" that changed between the time of determining the price set forth in the original contract with Mon Valley and the date of October 15, 1987, which was the date the contract was signed.

In the proceedings before Commonwealth Court, it was Armco/Allegheny, not West Penn, that argued for the recalculation of rates to reflect changes in the tax law between the time in 1986 when the original agreement

price was reached and the October 15, 1987 date of actual contract signing. In other words, West Penn itself did not argue that this recalculation as of October 15, 1987 should be made. In turn, what Armco/Allegheny specifically argued in its brief to Commonwealth Court at pages 24-27 and 33, in some detail, was that there should be a change in the capacity payment as a consequence of using federal and state tax law changes from 1986 to 1987. This is the *only* reason advanced by Armco/Allegheny on appeal to support its claim that the avoided cost calculations set forth in the agreement between West Penn and Mon Valley were too high.

Moreover, the Commonwealth Court, in deciding the case, specifically noted that the dispute concerned "only one input" and not a broad reassessment of all avoided cost inputs and capacity planning assumptions. The Court stated as follows:

> The dispute in this case concerns only one input—applicable corporate tax rates—to be used in calculating FAC. A calculation of FAC employing the method accepted by all the parties, but using the legally proper *tax rates*, will address the concerns raised by appellant Armco/Allegheny.
>
> We shall remand this case to the PUC with instructions that the Commission calculate West Penn's full avoided cost and corresponding capacity cost credit according to West Penn's method and using *tax rates* in effect at the time Mon Valley and West Penn executed their contract, which was the first time Mon Valley had done everything in its power to incur a legally enforceable obligation to deliver energy and capacity.

*Armco Advanced Materials Corp. and Allegheny Ludlum Corp. v. Pa. P.U.C.* (No. 2091 C.D. 1989, filed July 17, 1990), slip opinion at 10-11 (emphasis added). The precise language used by the court to address and resolve

the issues raised in this case demonstrates that the proper scope of the recalculation of avoided costs to be made by the Commission on remand is the change in "applicable corporate tax rates" as of October 15, 1987, the date of contract signing.

The court also noted that since this case involved a question of first impression, the decision should have only prospective effect. Since neither the Commission nor West Penn argued for the proposition that the payment calculations to Mon Valley should be changed, since the Commonwealth Court determined that the ruling should have prospective effect only, and since Armco/Allegheny argued *only* that changes in tax laws required a recalculation of the payments, we reaffirm the holding set forth in our opinion and order of December 5, 1991, that the recalculation should fully consider changes due to tax law changes affecting the calculations of an avoided cost as of October 15, 1987, but that any recalculation should *not* consider other claimed changes to inputs or capacity planning assumptions. Thus we will deny West Penn's petition for reconsideration.

Armco/Allegheny has failed to comply with our directive that it recalculate the payments to Mon Valley in accordance with tax law changes (the position advanced by *that* party) since it now contends that a "complete" avoided cost recalculation is required. Armco/Allegheny argues such a recalculation requires retroactive revision of West Penn's capacaity plans of 1987, changing the coal plant proxy to a gas combustion turbine and changing the on-line date of the utility plant, as well as changing various other inputs for 1987.

Armco/Allegheny further argues that the Commission did not have jurisdiction to proceed with this matter and that the rate recalculation should reflect all the additional changes now proposed by Armco/Allegheny. It is quite clear that the Commission has jurisdiction over this matter, since the Pennsylvania Supreme Court has denied our

petition for allowance of appeal. It was Armco/Allegheny itself which chose the arguments to advance to Commonwealth Court in support of its contention that a recalculation of the capacity payments as of October 15, 1987 should be made. Until this recent stage of the proceeding, Armco/Allegheny did not argue, nor did any other party, that as of October 1987 West Penn would have no need for capacity additions over the next ten years. Nor did Armco/Allegheny argue that the calculations of payments for qualifying facility capacity with contracts signed in 1987 should reflect anything other than changes occasioned by changes in tax laws. These newly conceived arguments have been waived and are not within the scope of Commonwealth Court's July 17, 1990 decision and order. Furthermore, since Armco/Allegheny has failed to provide us with any recalculations that it believes appropriately reflects such changes, we will of necessity review those submitted by West Penn and Mon Valley. The petition of Armco/Allegheny for rescission and amendment of our opinion and order of December 5, 1991 is denied.

West Penn submitted recalculations similar to those originally made for the electric energy purchase agreement (EEPA) with Mon Valley, but updated to reflect Pennsylvania and federal corporate income tax rates in effect on October 15, 1987. As directed in our order, West Penn provided such calculations assuming various in-service dates for the project, beginning with September 1, 1992 and going through October 1, 1995. This yielded a capacity cost varying from 3.37 cents per KWH to 5.62 cents per KWH, concomitant with those various in-service dates. As it did in its petition for reconsideration, West Penn also contended that this series of recalculated numbers was not correct because not all inputs and capacity planning assumptions had been changed. As we have previously stated, it was Armco/Allegheny that persuaded the Commonwealth Court that the payment stream should

be recalculated, based on changes in tax laws, and that is the relief that the court provided for in its order.

West Penn now also contends, in 1992, that its capacity addition plans of 1986 and 1987 should be retroactively adjusted to show no short-term capacity additions, that its "future plans" of 1987 should be adjusted to show it would add combustion turbines and, therefore, that the capacity payments to Mon Valley should have been based on the low capital cost combustion turbines. Of course, such installations have low capital costs but extremely high fuel costs. Armco/Allegheny submitted a similar calculation with the reasoning that the changes in West Penn planning (reflected in plans post-dating the contract signing) indicate the "real" capacity needs for West Penn as of the time of contract signing with Mon Valley. However, neither West Penn nor Armco/Allegheny indicated or included in its calculations the fact that a combustion turbine would use far more expensive fuel and, therefore, that the overall rates to be paid to a qualifying facility would have to be adjusted to take that factor into consideration. Nonetheless, we need not reach any determination based on the use of combustion turbines.

West Penn has made this claim based on its current view of historical projections which included a number of qualifying facilities, not built even as of this date in 1992, as supplying capacity to West Penn, thereby *displacing* the 900 MW coal-fired plant which West Penn indicated it would otherwise need in its 1986 filing with the Commission. In fact, as noted by Mon Valley, West Penn in its 1987 PURPA § 210 filing with the Commission included not only the three projects involved in the consolidated proceedings before the Commission (Milesburg, Burgettstown and Mon Valley) but a number of other PURPA projects to be subsequently built, upon which it was depending to meet its capacity needs. Thus West Penn and Armco/Allegheny make the circular argument that based on the capacity which West Penn and its parent company planned to have, or have added in the

next few years, including 910 MW of capacity from PURPA projects not yet built, West Penn had no capacity needs as of October 15, 1987, extending over the next ten years. In other words, it did not need the capacity from the Mon Valley project because it was to get capacity from a number of projects including the Mon Valley project.

As Mon Valley correctly notes, the "change" from West Penn's 1986 plans to 1987 was that West Penn planned to meet its capacity needs over the next decade from capacity supplied *by PURPA projects* instead of building the 900 MW coal-fired units that West Penn originally intended to build. To now claim that West Penn does not need one or more of those projects because its plans showed the availability of capacity from a number of PURPA projects which have not been built constitutes circular reasoning. Nor does it follow that West Penn's plan to add combustion turbines, more than ten years after October 1987 (but again based on the presumption that PURPA projects would have supplied capacity to offset West Penn's prior projected need for a coal plant), indicates in any way that a combustion turbine is the appropriate model for calculating the capacity credit to be paid to Mon Valley pursuant to the Commonwealth Court's directive.

Furthermore, although West Penn attempts to escape the circularity of its reasoning by excluding the capacity to be supplied by the Shannopin, Burgettstown and a portion of the PURPA 5 project in its computations, the same faulty reasoning could be applied to any of the other 14 PURPA projects to reach the same erroneous conclusion, that each of these projects on an individual basis is replacing a combustion turbine plant. On the contrary, all of the 17 PURPA projects, including the Shannopin project, together serve to replace the capacity from West Penn's previously planned 900 MW coal plant and thus are entitled to an avoided capacity cost credit based on that type of generating plant.

In its submittal dated December 31, 1991, Mon Valley indicated that the capacity rates recalculated as of October 15, 1987, and effective for on-line dates of the project between October 1, 1992 and October 1, 1995, should be between 3.99 cents per KWH and 5.94 cents per KWH, depending upon the on-line date, with the later and higher payment correlating to the later on-line date. Mon Valley supported its recalculation in the affidavit and explanation provided by Dale J. Buras, who performed that recalculation. However, in a subsequent submittal of January 21, 1992, Mon Valley indicated that it had failed to properly recalculate the changes to the fixed charge rate for the fuel and material inventory of the avoided plant, which West Penn had correctly done in its submittal. Mon Valley also explained that the differences between its recalculation and that done by West Penn resulted from West Penn's not reflecting the changes in depreciation tax lives and investment tax credits which, along with the corporate income rate, was changed by federal legislation in 1986 (effective for the 1987 tax year). Mon Valley notes that this distorts the calculations, since the tax law changes resulted in not only lower corporate income tax rates but also a longer required period of depreciation and the lack of an investment tax credit.

Mon Valley then recalculated the payments using the revised fixed charge rate for fuel and material inventory as West Penn had done. Again, Mr. Buras thoroughly explained his calculations. The renewed recalculations set forth in the January 21, 1992 submittal produced capacity rates varying from 3.9802 cents per KWH to 5.9285 cents per KWH, with starting dates ranging from October 1, 1992 through October 1, 1995.

The Commission disagrees with the recent contentions of Armco/Allegheny and West Penn that the capacity needs of West Penn had changed from a need for 900 MW of additional capacity as projected in mid-1986, based on West Penn plans to build a 900 MW coal plant, to zero by October 15, 1987 when the capacity offset to

the proposed utility plant, as clearly and unequivocally demonstrated from West Penn's own filings with this Commission, was to be at least partially achieved by capacity provided from a number of PURPA projects, including the 80 MW from Mon Valley and approximately 123 MW from the two other PURPA projects whose contracts were considered along with the Mon Valley contract. Those contracts have been interminably litigated along with that of Mon Valley. The view that the Mon Valley capacity is no longer needed is particularly unacceptable since it has been Armco/Allegheny and West Penn which have caused the litigation creating considerable uncertainty as to whether these projects will be completed. Moreover, it is not persuasive for these parties to suggest that as of October 15, 1987, capacity was not needed over the next decade due to capacity addition plans which include the supply of over 200 MW of capacity from the very plants from which West Penn now refuses to make purchases on the basis that it no longer had a future need for capacity in October of 1987.

Based on the foregoing, we will deny the petitions presented by Armco/Allegheny and West Penn and we find that the "revised" recalculations made by Mon Valley, as set forth at page 3 of Mon Valley's "response" dated January 21, 1992, appropriately carries out the direction of Commonwealth Court on remand and appropriately reflects the capacity payments to be made to Mon Valley, updated to reflect the "applicable corporate tax rates" effective as of October 15, 1987, as the Court has directed. We direct that the contract previously entered between West Penn and Mon Valley shall remain in effect, with modifications made as directed in our other orders in this proceeding, and with a modification to reflect the capacity rate of between 3.9802 cents per KWH to 5.9285 cents per KWH, depending upon the effective on-line date of the project; THEREFORE,

IT IS ORDERED:

1. That the petition for reconsideration filed by West Penn Power Company and the petition for rescission and amendment filed by Armco/Allegheny are denied.

2. That the motion for expedited consideration filed by Armco/Allegheny is granted. The motion that the Commission take administrative notice of the Armco/-Allegheny attachment to its pleading is denied.

3. That the recalculations as set forth in the Mon Valley submittal of January 21, 1992, producing capacity rates varying from 3.9802 cents per KWH to 5.9285 cents per KWH, with concommitant project on-lines ranging from October 1, 1992 through October 1, 1985, are hereby accepted as the appropriate recalculation reflecting inputs modified due to tax law changes, as directed by Commonwealth Court.

4. That the contract (EEPA) previously entered by West Penn and Mon Valley shall remain in effect with modifications to reflect the above capacity rates, contingent upon the effective on-line date of the project.

5. That a copy of this order be served upon all parties to these proceedings.

6. That this proceeding be terminated.

BY THE COMMISSION,

/s/ John G. Alford
JOHN G. ALFORD
Secretary

(SEAL)

ORDER ADOPTED: May 21, 1992

ORDER ENTERED: May 22, 1992

## APPENDIX W

COMMONWEALTH COURT OF PENNSYLVANIA

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WEST PENN POWER COMPANY,
*Peitioner,*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent,*

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ARMCO ADVANCED MATERIALS CORPORATION
and ALLEGHENY LUDLUM CORPORATION,
*Peitioners,*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
*Respondent.*

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Argued Oct. 21, 1992

Decided March 10, 1993

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Before CRAIG, President Judge, and DOYLE, COLINS, SMITH, PELLEGRINI, FRIEDMAN and KELLEY, JJ.

PELLEGRINI, Judge.

West Penn Power Company (West Penn) and Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Industrials), two large industrial customers of West Penn, appeal an order of the Public Utility Commission (PUC), recalculating West Penn's avoided cost

as being supplied power by Mon Valley Energy Company's (Mon Valley) Shannopin plant rather than having to construct its own capacity.[1] The PUC order was issued as a result of this court's order in *Armco Advanced Materials Corporation and Allegheny Ludlum Corporation v. Pennsylvania Public Utility Commission*, No. 2091 C.D. 1989, memorandum opinion filed July 17, 1990 (*Shannopin I*), directing the PUC to recalculate the capacity credit costs reflecting the avoided costs West Penn proposed to pay for energy purchased from Mon Valley's Qualifying Cogeneration Facility (QF).[2] The recalculation was necessary because the PUC had calculated costs at the time there were "serious negotiations" rather than at the time there was a "legally enforceable obligation" between West Penn and Mon Valley.[3]

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[1] The Public Utility Regulatory Policies Act of 1978 (PURPA) and implementing regulations promulgated by the Federal Energy Regulatory Commission (FERC) regulate West Penn's purchase of power from Qualifying Cogeneration Facilities. PURPA was part of a package of five pieces of legislation known collectively as the National Energy Act. Section 210 of PURPA, 16 U.S.C. § 824a-3, is designed to lessen the dependence on foreign oil and material [*sic*] gas by encouraging the development of alternative power sources in the form of cogenerators and small production facilities. *Barasch*, 119 Pa.Commonwealth Ct. 81, 85, 546 A.2d 1296, 1298 (1988), *reargument denied*, 119 Pa.Commonwealth Ct. 115, 550 A.2d 257 (1988) (*Milesburg I*).

[2] PURPA defines "cogeneration facility" as one that produces both electric energy and steam or some other form of useful energy, such as heat, 16 U.S.C. § 796(18)(A), and "small power production facility" as one that has a production capacity of no more than 80 megawatts (MW) and uses as a primary energy source biomass, waste, geothermal resources or renewable resources such as wind, water or solar energy to produce electric power. 16 U.S.C. § 796(17)(A). Together, they are commonly known as "qualifying facilities" or QFs.

[3] Our Order reads as follows:

> NOW, July 17, 1990, the order of the Pennsylvania Public Utility Commission at Docket No. P-880286, entered September 29, 1989, is affirmed in part and modified in part. The

The PUC interpreted our order to require recalulation of only the corporate tax rate component of the avoided cost, contending that was the only component challenged by West Penn and the Industrials and raised in *Shannopin I*. West Penn and the Industrials appealed that interpretation, asserting that they challenged the entire avoided cost calculation as evidenced by the plain language of our opinion and order purportedly requiring recalculation of all components of the avoided cost.

As with most QFs in Pennsylvania which had entered into voluntary agreements with the utilities to purchase their power, Shannopin has a long and complex legal history both before the PUC and this court. It began on September 10, 1986, when West Penn and Mon Valley agreed in principle that West Penn would purchase energy from a Mon Valley proposed Shannopin plant in lieu of West Penn building a coal-fired facility.[4] Based on the avoided cost to West Penn, a proposed rate of $.04 per kilowatt hour (KWH) for the QF energy was to be charged to West Penn's ratepayers and paid to Mon

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order is modified so that the approval of the Electric Energy Purchase Agreement between West Penn Power Company and Mon Valley Energy Corporation shall provide that a calculation of the capacity cost credit shall relate to factors in existence at the time the EEPA was signed, October 15, 1987, rather than as of the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of the capacity cost credit, according to the method of calculation employed by West Penn through these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for October 15, 1987.

[4] Mon Valley planned to build an 80 MW QF at the Shannopin Mine in Greene County. Under the agreement, the Shannopin Project was to replace part of a coal-fired power plant comprised of three-300 MW units that West Penn had scheduled to be in service in 1995, 1997 and 1998.

Valley.[5] With the proposed capacity rate unchanged,[6] West Penn and Mon Valley entered into an agreement for the purchase of the QFs. The agreement, however, was conditioned upon the PUC's approval. Approval was necessary to insulate West Penn from complaints that the rate of power from the plant was too high or the capacity was excess.

When West Penn filed a petition with the PUC seeking approval of the agreed-to rate recovery amounts, the Industrials opposed, arguing that the proposed rate was improperly calculated. Without a hearing, the PUC rejected the Industrials' challenge and issued a Tentative Opinion and Order approving West Penn's petition. However, in *Barasch v. Pennsylvania Public Utility Com-*

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[5] The calculation of the rate to be charged for QF energy is based in part on the utility's pass-through to ratepayers of avoided capacity costs. Capacity costs are those energy costs associated with providing the capability to deliver energy, primarily the capital costs of facilities. *See* the preamble to the publication of 18 C.F.R. § 292.101, the definitions section of the regulations promulgated by FERC pursuant to PURPA, 45 Fed.Reg. 12216. Avoided costs means the incremental cost to an electric utility of electric energy or capacity or both, which, but for the purchase from the qualifying facility, such utility would generate itself or purchase from another source. 18 C.F.R. § 292.101(b)(6) (4-1-86). Avoided costs are calculated when "a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided capacity and energy costs." *Id.*

[6] In the September 1986 agreement in principle, West Penn had calculated the avoided cost for the coal-fired facility, in part, on a federal corporate tax rate of 46% and a Pennsylvania corporate tax rate of 9.5%. However, at the time the contract was finalized, the Tax Reform Act of 1986, P.L. 99-514, 100 Stat. 2085, had decreased the federal corporate tax rate to 40% in 1987 and then 34% in 1988. The Pennsylvania rate had decreased from 9.5% to 8.5% on January 1, 1987.

*mission*, 119 Pa.Commonwealth Ct. 81, 546 A.24 1296, *reargument denied*, 119 Pa.Commonwealth Ct. 115, 550 A.2d 257 (1988) (*Milesburg I*), we held that because the approval of an electric energy purchase agreement (EEPA) by the PUC was adjudicatory in nature and involved substantial property rights of ratepayers, due process required that a utility's customers must be provided with notice of and an opportunity to comment on the proposed action. Relying on that decision, the PUC withdrew its Tentative Opinion and Order and consolidated the Shannopin Project petition with related West Penn/QF contract cases.

As with all the cases involving QFs, in Shannopin's proceeding, there was an issue as to whether the avoided cost calculation should be made at the time there were "serious negotiations" (September 10, 1986) or when there was a "legally enforceable obligation" to purchase power (October 15, 1987). The PUC found that the avoided cost was to be calculated at the time there were "serious negotiations" between the utility and the QF because that was when the utility made its calculation to determine its avoided costs and whether it would enter into the agreement.

The Industrials appealed the decision of the PUC to this court, claiming that the proposed rate should be calculated at the time there was a "legally enforceable obligation," stating that the lower corporate tax rates in effect at the time the contract was finalized would result in a lower calculation of avoided cost. In the reported *Armco Advanced Materials v. Pennsylvania Public Utility Commission*, 135 Pa.Commonwealth Ct. 15, 579 A.2d 1337 (1990) (*Milesburg II*), we held that under FERC regulations, the time when a QF executes a contract with a utility or when it otherwise does everything in its power to create a legally enforceable obligation to deliver energy and capacity is the time when the PUC must calculate the utility's avoided costs to deter-

mine the reasonableness of the proposed contract rates. Applying the *Milesburg II* holding, we directed in our *Shannopin I* opinion that:

> The Commission calculate West Penn's full avoided cost and corresponding capacity cost credit according to West Penn's method and using tax rates in effect at the time Mon Valley and West Penn executed their contract, which was the first time Mon Valley had done everything in its power to incur a legally enforceable obligation to deliver energy and capacity.

Upon remand, the PUC entered an order directing that the interested parties submit recalculations of the proposed capacity rate based solely on the change in corporate tax rates that occurred between the time of "serious negotiations" and a "legally enforceable obligation." After receiving recalculations from West Penn, Mon Valley and the Industrials, the PUC accepted the recalculation submitted by Mon Valley because it was the only recalculation that reflected changes in the corporate tax rates.[7] West Penn and the Industrials recalculated the rate by updating all the components of avoided cost. This appeal followed.[8]

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[7] In support of its petition, the Industrials included the deposition testimony of Stephan J. Baron as an expert witness. Baron recalculated the avoided cost, changing the avoided capacity and proxy unit factors, as well as the tax rate factors. Mon Valley's response to the petitions for reconsideration included the sworn statement of Dale J. Buras as an expert witness. Buras recalculated the avoided cost, changing only the tax figures, including system energy need filings made by West Penn from 1986 to 1987 to support Mon Valley's position that avoided capacity and the appropriate proxy unit were unchanged from 1986 to 1987.

[8] When additional evidence has been taken on remand and the PUC has made findings of fact and conclusions of law, our scope of review is limited to a determination of whether the PUC abused its discretion or committed an error of law. *Omiridis v. Zoning Hearing Board of the City of Chester*, 110 Pa.Commonwealth Ct. 247, 531 A.2d 1196 (1987).

At issue in this case is whether the PUC improperly implemented our remand order in *Shannopin I* by only recalculating corporate tax rates as of the date there was a "legally binding agreement" and not recalculating all the other factors as of that date that make up that rate. The PUC and Mon Valley contend that it was proper for them to recalculate just the corporate tax component to determine avoided cost. They argue that in *Shannopin I*, that was the only component of avoided cost that the Industrials claimed changed between the time of "serious negotiations" and "binding agreement." Because the accuracy of other components of the avoided cost were not raised in the previous appeal, they contend those components were not placed at issue and were waived. They further argue that our order in *Shannopin I* only requires the PUC to recalculate avoided cost by changing the corporate tax rates to reflect the rate at the time there was a legally enforceable agreement.

To the contrary, the Industrials and West Penn assert that they argued in *Shannopin I* for recalculation of all components of the avoided cost that may have changed between the time of serious negotiations and the finalized agreement legally enforceable obligation. They argue that corporate tax rates were only specifically questioned to illustrate the difference in what the avoided cost would be if it was calculated at the time of a "serious negotiation" or a "legally enforceable agreement" [9] and to show

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[9] West Penn and the Industrials contend that using the ten year projection period in the calculation methodology purportedly accepted by all parties, a recalculation of West Penn's capacity need as of October 1987 would reflect zero capacity need. As a result, they contend that the rate should reflect zero avoided capacity cost. Alternatively, they argue if the calculation time period is extended to the point where there is a projection for capacity need, 2003/2004 approximately seventeen years from the contract date, the avoided capacity rate would be between $.0051 and $.0078/KWH.

The difference between the PUC rate and the rate proposed by West Penn is approximately $28,800,000 per year over the thirty

that the "serious negotiation" standard was unworkable and why the complete avoided cost calculation (not just taxes) should be calculated when the contract was signed. Moreover, even if we determined that they only raised the issue of corporate taxes, they argue that our holding, changing the date when the avoided cost is to be calculated, mandates that all the components of avoided cost be recalculated as of that date. We agree.

Our order in *Shannopin I* directed that a recalculation be made relating to "factors in existence at the time the [agreement] was signed," and that the calculation was to "use inputs" appropriate for October 15, 1987, when there was a "legally enforceable agreement." The language of our order indicated that we anticipated more than a single factor or input would be recalculated by the PUC in order to comply with the requirement that calculation of avoided costs be made at the time of a legally enforceable obligation. The order anticipated a recalculation encompassing all avoided cost figures as of October 15, 1987.[10]

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year term of the contract, or $864,000,000. In part, they contend that this lower rate is based on changing the "proxy" unit that Mon Valley's Shannopin plant would replace from coal fired to a gas turbine plant that has a lower cost to operate. They contend that the gas turbine plant "proxy" is appropriate because West Penn no longer needs an increase in its base load, but its "peak" load to be supplied by a gas turbine plant.

The PUC and Mon Valley disagree, however, maintaining that at the time of the contract signing in October 1987, West Penn's filings demonstrated 900 MW of unmet capacity need which West Penn planned to purchase from seventeen unidentified and four identified qualifying facilities, with the proxy unit remaining a coal-fired plant.

Assuming the PUC did not have an independent obligation to examine the filings, and West Penn is bound by those filings, the Industrials are not bound and the PUC is obligated to make a finding as to what is the appropriate "proxy."

[10] Pursuant to Pa.R.A.P.) 2116, Mon Valley filed a Motion to Quash or, alternatively, limit the scope of West Penn and the

A total recalculation was inevitable as a result of the outcome in *Shannopin I* of changing when avoided cost was to be calculated. Whether the capacity rate of power purchased from a QF is "just and reasonable" to the consumer is, in part, based on time-sensitive data, e.g., tax rates, interest rates and capacity needs. In *Shannopin I* and *Milesburg II*, at issue was the appropriate time to conduct a review. The resolution of that issue determined whether the corporate tax rate was correctly calculated. But it did more. By holding that the PUC used the wrong date to conduct a review of the agreement, we held that the entire calculation of avoided costs was erroneous, not just one element of that calculation. By fixing as the "polestar" the date that the parties entered into a "legally enforceable obligation," we required the PUC to determine as of that date whether the avoided cost component of the capacity cost agreed to by the utility and the QF was "just and reasonable" to the ratepayers. 18 C.F.R. § 292.304(d)(2). Because a determination of whether an avoided cost element of the capacity cost credit is fair is based on time sensitive data, the PUC cannot change just one element to obtain an accurate calculation. It has to make that determination as if that calculation had not been made before and examine all the elements that determine avoided cost. That result is the same as if we found that the PUC used the wrong "test year" to determine a utility's revenues and expenses. If that occurred, the PUC is required to re-examine all the data, not just an item or two.

More importantly, this outcome is mandated by PURPA. Although that regulatory scheme permits utilities and QFs, as they did here, to negotiate private agree-

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Industrials' appeal, contending that this appeal is limited by the statement of questions presented by the Industrials in its March 27, 1990 brief filed in *Shannopin I*. Because what is at issue here is what we ordered in *Shannopin I*, what we decide that order meant was before us in that proceeding. The Motion is denied.

ments for the purchase of power independently of the prescribed rates, 18 C.F.R. § 292.301, "privately negotiated contracts setting rates for QF power are essentially outside the federal and state rules; state public utility commissions have the duty to examine such contracts claimed by the utility for the purpose of setting its own rates." *Barasch (Milesburg I)*, 119 Pa.Commonwealth Ct. at 90, 546 A.2d at 1300 (1988). Under PURPA, the PUC is required to determine whether the cost of purchased power is "just and reasonable" to the electric consumers and in the public interest." 16 U.S.C. § 824a-3(b) and 18 C.F.R. § 292.304(a). Otherwise, ratepayers would be required to subsidize the QF.[11] Moreover, if it approves the agreement, the PUC agrees never to include in any excess power calculation power purchased from Mon Valley under this agreement.[12]

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[11] Congress did not intend the ratepayers to subsidize their construction or operation. The Conference Committee stated:

> The provisions of this section are not intended to require the ratepayers of a utility to subsidize cogenerators or small power producers. H.R.Conf.Rep. No. 95-1750, pp. 97-98 (1978);

reprinted in 1978 U.S.C.C.A.N. 7831-7832.

[12] Where the PUC determines that a utility is producing excess capacity, it may exclude the value of the property producing the excess from the rate base and disallow the utility's return on that property. Section 1310(d) of the Public Utility Code, 66 Pa.C.S. § 1310(d), states that:

> Whenever the commission . . . shall be of the opinion that any rates of such public utility are producing a return in excess of a fair return upon the fair value of the property of such public utility, used and useful in its service, the commission may, by order, prescribe for a trial period of at least six months, . . . temporary rates . . .

"Used and useful in its service" is interpreted by the PUC to mean whether a property's total capacity is commensurate with the requirements for peak demand, plus a reasonable reserve margin relative to the system and obligation. *Pennsylvania Power and Light Company v. Pennsylvania Public Utility Commission*, 101 Pa.Commonwealth Ct. 370, 516 A.2d 426 (1986).

Our holdings in *Milesburg II* and *Shannopin I* that PURPA mandates that avoided cost be calculated at the time there is a "legally enforceable obligation" require the PUC to determine as of that date whether the cost to consumers of the contract is just and reasonable, including whether consumers will be required to pay for excess capacity. This obligation imposed on the PUC is not diminished by whether or not any ratepayer intervenes to oppose approval of the agreement and is not limited to only those issues that intervenors raise.

Accordingly, the order of the PUC recalculating the capacity cost for the Shannopin project is vacated. This case is remanded to the PUC to make a new calculation of capacity cost credit using inputs and criteria appropriate for October 15, 1987.

ORDER

AND NOW, this 10th day of March, 1993, the order of the Pennsylvania Public Utility Commission dated May 22, 1992, Docket No. P-880286, is vacated. This case is remanded to the PUC to make a new calculation of capacity cost credit using inputs and criteria appropriate for October 15, 1987. Mon Valley's Motion to Quash is denied.

Jurisdiction is relinquished.

## APPENDIX X

## THE SUPREME COURT OF PENNSYLVANIA
## WESTERN DISTRICT

CHARLES W. JONES, ESQUIRE
Prothonotary

IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
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September 30, 1993

Clifford B. Levine, Esquire
Alice B. Mitinger, Esquire
THORP REED & ARMSTRONG
One Riverfront Center
Pittsburgh, PA 15222

In re: West Penn Power v. P. U. C.
Petition of: Mon Valley Energy Corporation
No. 0195 W.D. Allocatur Docket 1993
Armco Advanced Materials Corporation, et al.
v. P. U. C.
Petition of: Mon Valley Energy Corporation
No. 0196 W. D. Allocatur Docket 1993

Dear Mr. Levine and Ms. Mitinger:

In accordance with the Praecipe To Discontinue Appeal filed September 29, 1992 [*sic*] in the above-captioned matters, these Petitions for Allowance of Appeal have been discontinued of record and Certificates of Discontinuance have been sent to the Court below.

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

**APPENDIX Y**

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105

Public Meeting held February 3, 1994

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Commissioners Present: David W. Rolka, Chairman
Joseph Rhodes, Jr.,
Vice Chairman
John M. Quain
Lisa Crutchfield
John Hanger

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Docket No. P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT RE: SHANNOPIN MINE PROJECT

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TENTATIVE ORDER

BY THE COMMISSION:

The issue before us for consideration in this part of the proceedings at Docket No. P-880286 involves implementation of the second remand of these proceedings to the Commission by the Commonwealth Court. This proceeding has been pending before the Commission in various forms for the last six years, commencing with the filing by West Penn Power Company (West Penn) of a petition seeking approval of recovery from its ratepayers for costs incurred under an agreement between West Penn and Mon Valley Energy Corporation (Mon Valley) for the purchase of electric energy and capacity from Mon Valley. The contract was signed on October 15, 1987.

On August 27, 1993 Mon Valley filed with the Commission a petition for recalculation of the capacity payment. That petition sought to have implemented the Commonwealth Court decision which remanded the matter to the Commission for the second time. *West Penn Power Co. v. Pa. P.U.C.*, —— Pa. Commonwealth Ct. ——, 623 A.2d 383 (1983) (*Shannopin III*).

Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny) and West Penn had appealed the Commission order entered May 22, 1992. In that order, the Commission had carried out what it believed to be the specific direction of the Commonwealth Court in the original decision in *Shannopin I*.[1] The Commonwealth Court in *Shannopin I* remanded the proceedings to the Commission and the Court directed that the Commission recalculate the payments to Mon Valley, according to West Penn's methodology but using tax rates in effect on the date when the contract was entered (October 15, 1987). Therefore, the Commission on remand held that recalculations should reflect only changes in tax laws between the time in 1986 that the rates were originally agreed upon and October 15, 1987. Armco/Allegheny and West Penn appealed from that Commission decision on remand. Commonwealth Court, in its decision in that case (*Shannopin III*), held that the recalculation should reflect *all* changes in inputs between 1986 and October 15, 1987, thus the Commonwealth Court remanded the matter again to the Commission to make such a determination.

## BACKGROUND

After West Penn's original filing for approval of rate collection, there were numerous proceedings before the Commission, including numerous orders and a tentative

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[1] *Armco Advanced Materials Corp. v. Pa. P.U.C.*, No. 2091 C.D. 1989, filed July 17, 1990, *allocatur denied*, 545 W.D. Allocatur Docket 1990, November 17, 1991.

decision approving the payments to Mon Valley as being just and reasonable and in compliance with the Public Utility Regulatory Policies Act of 1978, Section 210 (16 U.S.C. § 826 a-3). Ultimately, there were substantial evidentiary hearings involving four contracts entered by West Penn with four different qualifying facilities. The hearings were consolidated, so that all questions concerning the propriety of the contracts were fully explored, including the need for capacity and the appropriate avoided cost model. Since Allegheny Power System, Inc. (APS) would have built a 900 MW coal-fired generating plant but for the availability of capacity from these and other qualifying facilities, West Penn based its payments on that planned coal plant. The Commission found this proper, in accord with PURPA § 210, 18 C.F.R. § 292.101 *et seq.* and 52 Pa. Code 57.31 *et seq.*

One of the other projects had a contract entered on October 15, 1987, precisely the same date as the Mon Valley contract. That was the contract between West Penn and North Branch Energy Partners, L.P. (North Branch), the developer of a project near Burgettstown which has become known as the Burgettstown Project. (Therefore, proceedings concerning that project are generally referred to as "Burgettstown"). Commission proceedings and orders involving the Burgettstown project have also lead to appeals by West Penn and Armco/Allegheny. The appeals involving Shannopin, Burgettstown and another facility known as the Milesburg Project were all from the same Commission order, thus the appeals were consolidated. Like *Shannopin I*, the proceedings in *Burgettstown I* [3] were also remanded to the Com-

[2] APS is the parent company of West Penn. APS's generation planning is done on a system basis, with each subsidiary owning all or a part of the generating plants. West Penn would have owned part of the 900 MW plant.

[3] *Armco Advanced Materials Corp. v. Pa. P.U.C.*, Nos. 2090 and 2097 C.D. 1989, filed September 7, 1990, *allocatur denied* 531 W.D. Allocatur Docket 1990, November 19, 1992.

mission for recalculation of the payments as of October 15, 1987. In the order remanding the proceeding to the Commission, the Commonwealth Court in *Burgettstown I* did not include language specifically referring to tax law changes between 1986 and 1987. The Commission addressed the Burgettstown recalculation after first addressing the Shannopin recalculation on remand. By the time the Commission addressed the Burgettstown remand, West Penn and Armco/Allegheny had appealed from the Commission's decision in the Shannopin remand proceeding. Recognizing that specific language referring to tax law changes was absent from the *Burgettstown I* Court order, the Commission directed that recalculations in the Burgettstown remand proceeding be made in two ways, one showing input changes only reflecting tax law changes, and the second showing a recalculation reflecting *all* input changes between 1986 and October 15, 1987.

The Commission entered its order on the remand in the Burgettstown proceedings, at Docket No. P-880284, on November 24, 1992. That order specifically noted that the *Burgettstown I* decision had not mentioned the tax law changes, and specifically indicated that, since Armco/Allegheny and West Penn had appealed from the Shannopin remand proceedings, there was further delay in progress of the Shannopin project. For those reasons, the Commission accepted the recalculation of Burgettstown's capacity payments reflecting *all* input changes as of October 15, 1987.

The Commission's order in the Burgettstown remand proceedings noted that Commonwealth Court had remanded the proceedings to the Commission for the very limited purpose of having a recalculation of the capacity payments and that those recalculations were to be done without the necessity of evidentiary hearings. Commission Order entered November 24, 1992, p. 3. The order also noted that the parties in the original appeal had not suggested that there was a lack of West Penn capacity

need on October 15, 1987. Further, the order noted that the Commonwealth Court had not in any manner suggested that the remand proceeding be expanded to consider matters beyond the scope of the recalculations. Order entered November 24, 1992, pp. 3-4. The order stated that Commonwealth Court had clearly envisioned that evidentiary hearings would not be necessary and that written calculations of the new capacity payments would suffice. Order entered November 24, 1992, pp. 5-6. Finally, the order extensively discussed the Armco/Allegheny and West Penn contentions that capacity needs had changed, rejecting those contentions. The Commission specifically held that the calculations for the Burgettstown project reflecting "all inputs" changes were appropriate and acceptable.

Notwithstanding the Commission's acceptance of recalculations changing all inputs as of October 15, 1987, both West Penn and Armco/Allegheny appealed from the Commission's decision on remand in the Burgettstown proceeding. Commonwealth Court affirmed the Commission's remand decision. *Armco/Advanced Materials Corp. v. Pa. P.U.C.*, —— Pa. Commonwealth Ct. ——, 629 A.2d 221 (1993) (*Burgettstown II*). In *Burgettstown II*, Commonwealth Court affirmed its holding in *Shannopin III*, that the PUC had to base the recalculation of costs in the remand "on factors *known as of the date the legally enforceable obligation was incurred.*" *Burgettstown II*, Slip. Opinion at 11, emphasis in original. The Court also affirmed its decision in *Shannopin II*,[4] finding the Commission could properly determine that West Penn needed capacity when it signed the contract. The *Burgettstown II* court also held that an evidentiary hearing on the recalculation was not necessary, in part based on Commonwealth Court's decision in *Armco Advanced Materials Corp. v. Pa. P.U.C.*, 135 Pa. Commonwealth Court 15,

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[4] *West Penn Power Co. v. Pa. P.U.C.*, 150 Pa. Commonwealth Ct. 349, 615 A.2d 951 (1992) *allocatur denied* 663 and 672 W.D. Allocatur Docket No. 1992, Order entered December 30, 1993.

579 A.2d 1337 (1990) (*Milesburg II*), *affirmed per curiam*, —— Pa. ——, —— A.2d —— (1993). Thus the Commonwealth Court decisions in *Shannopin II*, *Shannopin III* and *Burgettstown II* provide clear instructions as to the Commission's course of action in the instant proceeding.

## DISCUSSION

Mon Valley in the instant petition has requested that the Commission carry out the recalculation for the Shannopin project in the same manner as that approved by the Commonwealth Court in *Burgettstown II*. Mon Valley has also requested that the recalculations be based on in-service dates from October 1994 through October 1998. We agree that this is appropriate. In the Burgettstown remand recalculation and the original Shannopin recalculation, the Commission had directed the parties to initially perform their own calculations, with the opportunity to then respond to each others' calculations. We believe that this provided full opportunity for the parties to present their claims. Nonetheless, the Commonwealth Court's specific language technically directs that the Commission first perform the calculations itself, then allowing the parties an opportunity to respond to those calculations. Therefore, attached to this order as "Attachment A" is a set of calculations performed by Commission staff, based on the West Penn methodology for calculating payments to qualifying facilities and based on certain factors previously made part of the record in this proceeding.

Specifically, West Penn, (in its submittal in the first remand) dated December 30, 1991, included a number of attachments showing 1987 estimates of components of capacity payment calculations for construction in the 1990's. Attachments 26 and 27 to the West Penn submittal show a cost of capital as being 11.55% and show a projected construction cost escalation rate of 5%. Page one of Attachment 26 lists various fixed charge rates

for West Penn and its sister operating companies. From these figures, an overall fixed charge rate (FCR) of 15.8% can be calculated. These figures for cost of capital and a construction cost escalation rate and the FCR percentages were also used by Mon Valley's witness Dale Buras in his calculations of Shannopin project capacity payments with all inputs changed as of October 15, 1987. (Supplemental Affidavit of Dale Buras, Exhibit A to Mon Valley response, dated January 21, 1992.)

The same cost of capital and construction cost escalation rates were utilized by Mr. Buras in his recalculation of the capacity payments to the Burgettstown project, as set forth in Exhibit A to the North Branch Energy Partners' calculations submitted on July 6, 1992, at Docket No. P-880284. In turn Commonwealth Court accepted the recalculations for the Burgettstown project, as set forth in our order of November 24, 1992 at the same docket number. Commonwealth Court affirmed the Commission's determination that the North Branch recalulations were correct as of October 15, 1987, in the Court decision in *Burgettstown II*. Since Commonwealth Court has approved that recalculation derived from input changes, in addition to tax law changes, as being the correct recalculation for another contract entered October 15, 1987, use of those same factors for a contract also entered on that date is unquestionably correct. As stated above, attached as Attachment A to this order is a set of recalculations performed by Commission staff using the inputs described above. Our only concern about these calculations is that the fixed charge rate of 15.8% may not have reflected elimination of the investment tax credit and a longer period of depreciation required due to federal tax law changes from 1986 to 1987. If such changes are not included in the FCR of 15.8%, then a more accurate FCR would be somewhat higher, with a result that the capacity rate payable to Mon Valley would also be somewhat higher. Nonetheless, it appears that the FCR of 15.8% was acceptable to Mon Valley since

its witness used that rate in calculations he previously performed. Thus absent demonstration that the FCR fails to reflected elimination of the investment tax credit and the longer period of depreciation, the Commission considers its use appropriate. The Commission also again notes that it has taken and continues to take judicial notiec of the system cost data filed by West Penn pursuant to 52 Pa. Code § 57.33.

After the instant Mon Valley petition for recalculation, both Armco/Allegheny and West Penn filed answers to the petition and motions to dismiss the petition. The gist of the motions to dismiss was that a then-pending petition for allowance of appeal to the Pennsylvania Supreme Court somehow precluded the Commission's implementing Commonwealth Court's order on remand in *Shannopin III*. As we have discussed in prior orders, there is absolutely no basis for this contention. Regardless, Mon Valley withdrew its petition for allowance of appeal and West Penn and Armco/Allegheny subsequently withdrew their motions to dismiss. Concerning the respective answers to the petition for recalculation, both West Penn and Armco/Allegheny object to the Commission implementing the remand, claiming that West Penn does not need capacity, in spite of overwhelming evidence to the contrary. They also contend that Commonwealth Court's *Burgettstown II* decision was wrong and insist the Commission not follow that decision. We disagree and have recalulated the payments in a manner consistent with *Burgettstown II*. These parties, particularly West Penn, also attempt to raise completely irrelevant issues that are outside the scope of the original proceedings and the remand, such as the bankruptcy of the Shannopin Mine, which entity is wholly unrelated to this project. Ironically, those parties specifically sought appellate review of the order on remand and sought to have the proceeding remanded to the Commission. The position taken by West Penn and Armco/Allegheny is unreasonable in that the Commission is asked to refrain from taking reason-

able administrative actions to implement judicial directions and to carry out the Commission's responsibilities under PURPA. Therefore, we grant the petition of Mon Valley for recalculation, as we have indicated above.

The calculations set forth in seventeen pages in Attachment A represent what the Commission believes are the correct calculations of payments for capacity to the Shannopin project being developed by Mon Valley. These calculations produce capacity rates varying from 4.9538 cents/kwh to 8.0151 cents/kwh for concomitant project on-line dates ranging from October 1, 1994 through October 1, 1998. The parties to this proceeding may file with the Commission responses to these calculations within thirty days after entry of this order. Responses must also be served upon all parties of record within thirty days after entry of this order. Parties may also file and serve replies to each others responses within fifty days after entry of this order. Upon consideration of any responses and replies thereto, the Commission will enter a final order in this matter. If no responses are filed within thirty days after entry of this order, it shall become final. THEREFORE,

IT IS ORDERED:

1. That the petition of Mon Valley Energy Corporation for recalculation of the capacity payment to it, under its contract with West Penn Power Company, is granted.

2. That the calculations as set forth in Attachment A to this order represent a preliminary Commission determination of the appropriate payments to Mon Valley Energy Corporation, calculated as of October 15, 1987, the date of entry of its contract with West Penn Power Company, for in-service dates from October, 1994 through October, 1998.

3. That the parties to this proceeding may file with the Commission within thirty (30) days after entry of this order, written responses to the calculations set forth

in Attachment A. Responses shall also be served upon all parties of record within thirty (30) days after entry of this order. Any discussion of calculations offered by a witness shall be fully explained and documented, and shall be supported by affidavit where appropriate.

4. That the parties to this proceeding may file with the Commission replies to the responses of other parties, within fifty (50) days after entry of this order. Replies shall also be served upon all parties of record within fifty (50) days after entry of this order.

5. That responses and replies shall become part of the record in this proceeding. Upon consideration of any responses and replies, the Commission shall issue a final order in these proceedings. If no responses are filed within thirty days after entry of this order, it shall become final.

6. That the contract previously entered by West Penn Power Company and Mon Valley Energy Corporation shall remain in effect, with modifications as directed by the Commission in previous orders, and further modifications to reflect the above capacity rates, consistent with the effective on-line date of the project.

7. That a copy of this order be served upon all parties of record.

BY THE COMMISSION

/s/ John G. Alford
JOHN G. ALFORD
Secretary

(SEAL)

ORDER ADOPTED: February 3, 1994

ORDER ENTERED: February 7, 1994

[Attachment A Omitted in Printing]

## APPENDIX Z

**Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3. Cogeneration and small power production**

### (a) Cogeneration and small power production rules

Not later than 1 year after November 9, 1978, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production, and to encourage geothermal small power production facilities of not more than 80 megawatts capacity, which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

### (b) Rates for purchases by electric utilities

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to

offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

**(c) Rates for sales by utilities**

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

**(d) "Incremental cost of alternative electric energy" defined**

For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

**(e) Exemptions**

(1) Not later than 1 year after November 9, 1978, and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which geothermal small power production facilities of not more than 80 megawatts capacity, qualifying cogeneration facilities, and qualifying small power production facilities are exempted in whole or part from the Federal Power Act [16 U.S.C.A. § 791a et seq.], from the Public Utility Holding Company Act [15 U.S.C.A. § 79 et seq.], from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility (other than a qualifying small power production facility which is an eligible solar, wind, waste, or geothermal facility as defined in section 796(17)(E) of this title) which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts, or 80 megawatts for a qualifying small power production facility using geothermal energy as the primary energy source, may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act [15 U.S.C.A.

§ 79 et seq.] and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f) of this section,

(B) the provisions of section 210, 211, or 212 of the Federal Power Act [16 U.S.C.A. § 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C.A. § 791a et seq.], or

(C) any license or permit requirement under part I of the Federal Power Act [16 U.S.C.A. § 791a et seq.], any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

**(f) Implementation of rules for qualifying cogeneration and qualifying small power production facilities**

(1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

**(g) Judicial review and enforcement**

(1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric uitlity for purposes of implementing any requirement of a rule under subsection (a) of this section in the same manner, and under the same requirements, as judicial review may be obtained under section 2633 of this title in the case of a proceeding to which section 2633 of this title applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f) of this section. Any such action shall be brought only in the manner, and under the requirements, as provided under section 2633 of this title with respect to an action to which section 2633 of this title applies.

**(h) Commission enforcement**

(1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) of this section with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act [16 U.S.C.A. § 824 et seq.], such rule shall be treated as a rule under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. Nothing in subsection (g) of this section shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) of this section against any State

regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) of this section shall be treated as a rule enforceable under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) of this section or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) of this section as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

**(i) Federal contracts**

No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after November 9, 1978, may contain any provision which will have the effect of preventing the implementation of any rule under

this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

**(j) New dams and diversions**

Except for a hydoelectric project located at a Government dam (as defined in section 3(10) of the Federal Power Act [16 U.S.C.A. § 796(10)]) at which non-Federal hydroelectric development is permissible, this section shall not apply to any hydroelectric project which impounds or diverts the water of a natural watercourse by means of a new dam or diversion unless the project meets each of the following requirements:

(1) No substantial adverse effects

At the time of issuance of the license or exemption for the project, the Commission finds that the project will not have substantial adverse effects on the environment, including recreation and water quality. Such finding shall be made by the Commission after taking into consideration terms and conditions imposed under either paragraph (3) of this subsection or section 10 of the Federal Power Act [16 U.S.C.A. § 803] (whichever is appropriate as required by that Act [16 U.S.C.A. § 791a et seq.] or the Electric Consumers Protection Act of 1986) and compliance with other environmental requirements applicable to the project.

(2) Protected rivers

At the time the application for a license or exemption for the project is accepted by the Commission (in accordance with the Commission's regulations and procedures in effect on January 1, 1986, including those relating to environmental consultation), such project is not located on either of the following:

(A) Any segment of a natural watercourse which is included in (or designated for potential inclusion in) a State or national wild and scenic river system.

(B) Any segment of a natural watercourse which the State has determined, in accordance with applicable State law, to possess unique natural, recreational, cultural, or scenic attributes which would be adversely affected by hydroelectric development.

(3) Fish and wildlife terms and conditions

The project meets the terms and conditions set by fish and wildlife agencies under the same procedures as provided for under section 30(c) of the Federal Power Act [16 U.S.C.A. § 823a(c)].

**(k) Definition of new dam or diversion**

For purposes of this section, the term "new dam or diversion" means a dam or diversion which requires, for purposes of installing any hydroelectric power project, any construction, or enlargement of any impoundment or diversion structure (other than repairs or reconstruction or the addition of flashboards or similar adjustable devices).

**(l) Definitions**

For purposes of this section, the terms "small power production facility", "qualifying small power production facility", "qualifying small power producer", "primary energy source", "cogeneration facility", "qualifying cogeneration facility", and "qualifying cogenerator" have the respective meanings provided for such terms under section 3(17) and (18) of the Federal Power Act [16 U.S.C.A. § 796(17), (18)].

## APPENDIX AA

**Regulations Adopted By FERC, 18 C.F.R. §§ 292.301 & 304 (1993).**

**Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978**

**§ 292.301 Scope.**

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) Limits the authority or any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

* * * *

**§ 292.304. Rates for purchases.**

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) Be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) Not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from

capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to paragraph (b)(3) of this section, a rate for purchases satisfies the requirements of paragraph (a) of this section if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e) of this section.

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a) of this section, and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with paragraph (b)(2) of this section, regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) Shall be consistent with paragraphs (a) and (e) of this section; and

(ii) May differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) The avoided costs calculated at the time of delivery; or

(ii) The avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) The data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) The availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) The ability of the utility to dispatch the qualifying facility;

(ii) The expected or demonstrated reliabiltiy of the qualifying facility;

(iii) The terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) The extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) The usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) The individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) The smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) The relationship of the availability of energy or capacity from the qualifying facility as derived in paragraph (e)(2) of this section, to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) The costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.* (1) Any electric utility which gives notice pursuant to paragraph (f)(2) of this section will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make

such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke paragraph (f)(1) of this section must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of paragraph (f)(2) of this section will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in paragraph (f)(1) of this section not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the regulatory authority determines necessary or appropriate, either before or after the occurrence.

## APPENDIX BB

**Regulations Adopted By Pennsylvania PUC, 52 Pa. Code § 57.32 (1983).**

### § 57.32. Purpose and scope.

(a) *Purpose.* The purpose of this subchapter is to implement the provisions of section 210 of the Public Utility Regulatory Policies Act of 1978, Public Law 95-617, Title II, § 210, 92 Stat. 3144 (16 U.S.C.A. § 824a-3(a)-(j)). To this end, this subchapter details the requirements that utilities and qualifying facilities will have to meet concerning the filing of utility system cost data, the methodology to be used in establishing rates for sales and purchases, the responsibility for interconnection costs, the standards for system safety and reliability, and the processes by which the Commission will attempt to resolve disputes between utilities and qualifying facilities. This subchapter is intended to equalize the bargaining power of qualifying facilities with that of the utilities and protect the interests of the ratepayers. Nothing in this subchapter requires a qualifying facility to take advantage of the provisions of this subchapter. It is up to the qualifying facility to decide whether or not it wants to do so. Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities. Long term contracts are encouraged.

(b) *Applicability.* This subchapter governs the purchases and sales of energy or energy and capacity between qualifying facilities and electric utilities.

(c) *Negotiated contracts.*

(1) Nothing in this subchapter:

(i) limits or extends the authority of any electric utility to agree to a price for any purchase or to terms or conditions relating to any purchase which differ from the

terms or conditions which would otherwise be required by this subchapter; or

(ii) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase to the extent such contract is valid and in compliance with applicable statutes and regulations.

(2) Each utility shall file with the Commission a copy of any contract or agreement that it enters into with a qualifying facility with a design capacity of 500 kilowatts or more.